

***Small Business Strategy:***  
***an empirical analysis of the experience of new Scottish firms***

**Volume I**

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A thesis submitted in partial fulfilment of the requirements of the University of Abertay Dundee for the degree of Doctor of Philosophy

This research programme was carried out in collaboration with the Centre for Research into Industry, Enterprise, Finance and the Firm (CRIEFF), Department of Economics, University of St Andrews

**August 1997**

I certify that this thesis is the true and accurate version of the thesis approved by the examiners.

Signed .



(Director of Studies)

Date *19.9.97*.....

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## VOLUME II: APPENDICES

**Appendix I** Data Dictionary

**Appendix II** Administered Questionnaire

**Appendix III** Semi-Structured Questionnaire

**Appendix IV** Case Studies

**Appendix V** Publications:

Reid, G.C., P.A. Siler and J.A. Smith (1996) The Quality of Patenting in the UK Scientific Instruments Industry, Chapter 2 in Andrew Webster and Kathryn Packer (eds), 1996, *Innovation and the Intellectual Property System*, Kluwer Law International: Dordrecht, 23-46: ISBN: 90 41 10 90 72.

Reid, G.C. and J.A. Smith (1996), What Makes a New Business Start-up Successful?, CRIEFF Discussion Paper No.9618, Department of Economics, University of St Andrews.

Reid, G.C., N.G. Terry and J.A. Smith (1997), Risk Management in Venture Capital Investor-Investee Relations, *European Journal of Finance* 3, 27-47.



## ***Acknowledgements***

*The author would like to express her thanks to the following, for their support, useful comments and understanding during the drafting of this thesis:*

- *to Dr Pamela A Siler of the School of Social Sciences, Economics Division, University of Abertay Dundee, in her capacity as first supervisor;*
- *to Professor Gavin C Reid of the Centre for Research into Industry, Enterprise, Finance and the Firm (CRIEFF), Department of Economics, University of St Andrews, for the support he has provided in his role as advisor, for granting permission for this research to be carried out from the Centre of which he is Director (CRIEFF), for allowing one of the sections in his questionnaire to be dedicated to this study, and without whom this work would not have been possible;*
- *to Ms Judith Dunkerley and Ms Pat Dugard (both University of Abertay Dundee) for further supervision involvement;*
- *to Professor Christopher Jensen-Butler of the University of St Andrews, for ideas inspired by a discussion on the topic of information technology;*
- *to the many small business owner-managers throughout Scotland who have willingly taken part in the study, and who have been so helpful in giving detailed information on their businesses;*
- *to the various Enterprise Trusts involved, who provided the sample in the first place;*
- *and finally to The Leverhulme Trust, who have funded the research of Professor Reid, and who kindly agreed to the undertaking of a PhD by the full-time researcher on their funded project.*

## *Abstract*

This thesis aims to make a significant contribution to the development of the emerging literature on small business strategy. First, it conducts a critical review of the existing literature on strategy in general, and its relation to small firms in particular. Second, it investigates whether or not small firms do make strategic decisions, and discovers how these are incorporated into their long-term plans. Third, it establishes a link between the strategies employed by new small firms and their subsequent performance. And finally, it advises on the strategies and actions a small business should follow if it wishes to achieve high performance. As such, the work should be useful, not only to academics with an interest in new small firms, but also to practitioners and small business advisors.

The thesis explains how two fieldwork instruments were designed, for use in face-to-face interviews with the owner-managers of 150 young micro-firms throughout Scotland, over a two-year time period. This work led to the design and development of a new database, and the creation of 17 case studies on small business strategy. Cluster analysis was used to group the firms into high, medium and low performance categories. Then strategies followed by each performance category were analysed to discover why some were more effective than others. The case study evidence was used to support this analysis, further augmented by statistics from the administered questionnaire.

Seven propositions were developed, and empirically tested. Of these, the most notable were that: first, higher performers appear to have a better appraisal of their own strengths and weaknesses, as well as being more aware of opportunities and threats, compared to the lower performing firms; second, the implementation and continued use of information-technology has a statistically significant and positive effect upon performance; and third, the gathering of trade intelligence (e.g. marketing, quality) on rivals appears to enhance performance. Further propositions, on awareness, funding and ownership, round off the detailed picture provided of performance in the new small firm.

# Chapter 1

## Introduction: small business strategy

### 1.1 Introduction

This work sets out with the aim of making a significant contribution to the existing literature on small business strategy, based upon empirical evidence from primary source data. First, it will undertake a critical review of the literature on strategy, both for corporations, and as it relates to the small firm. It will develop two instruments, for use in fieldwork, to gather unique evidence on strategies in the new small Scottish firm. It will attempt to discover whether or not small firms can and do make strategic decisions, and how these are incorporated into their long-term plans. It will then try to establish links between the strategies followed by a new small firm and their subsequent performance, investigating whether the more visionary approach or formal strategic planning is most prevalent, and which is most successful. Finally, the thesis will prescribe strategies which should assist a business in achieving high performance. By dint of achieving all of the above, this work should make a significant contribution to the extant literature on small business strategy.

Chapter 2 commences with a critical analysis of the existing literature on strategy and the small firm, to establish any gaps that might exist. This analysis raises several issues which prove to be useful in the development of an administered questionnaire on small business strategy. Chapter 3 describes how the sample of young small firms was established, the administered questionnaire designed, and

face-to-face interviews conducted. It then explains how a second body of evidence was obtained with the aid of a new semi-structured interview schedule, used to develop 17 case studies.

Chapter 4 describes the construction and analysis of the database used to hold all of the quantitative information. Cluster analysis is used to divide the firms into groups of high, medium and low performers, and the strategies of each performance group are examined in turn, to establish which actions lead to the more successful firms. Chapters 5 and 6 extend this discussion to the qualitative evidence provided by the semi-structured interviews, supporting the findings with statistical tests on the quantitative data from the administered questionnaire. Finally, in Chapter 7, prescriptions are given for high performance which, it is hoped, should help owner-managers of new small firms to focus their goals towards achieving high performance. Thus the quantitative and qualitative data enable us to establish whether or not small firms can, and do, make strategic decisions and, if they do, how these are incorporated into their long-term plans.

This work is set within the larger context of a four-year study being conducted by Professor Gavin Reid, Director of CRIEFF at the University of St Andrews, and sponsored by the Leverhulme Trust. The quantitative evidence is drawn from one of seven sections of a questionnaire developed to examine the life-cycle effects of new small firms in Scotland. This thesis uses data from the first two years of the study, and takes information on performance measurements (such as turnover, profits and assets) from the other sections of the questionnaire, where relevant. It builds on earlier work by Reid, using similar fieldwork methods, and relies on previously established connections within the small business community in Scotland for privileged access to their databases of owner-managers of new small

firms. What distinguishes this work from other studies, though, are its unique method of tracking the firms over a four year time horizon (or two years, for this thesis), in order to observe the changes undertaken by a small firm as it grows into a larger and more profitable organisation, and the sample size of 150 firms, which is twice the size of Reid's (1993) earlier study. An additional unique feature of this work is its focus on strategy in the young, and very small (<10 employees), micro firm in Scotland during the 1990s.

## **1.2 Background to the study**

The strategy of a business is taken to be the plan of action or policies it pursues, in order to create for itself the best possible competitive advantage in the market place vis-à-vis its rivals. This study was prompted by the gap in the existing literature on business strategy for the small firm<sup>1</sup>, and with particular emphasis on the case for Scotland. There exists an immense amount of work related to strategy in large corporations [*cf.* Ansoff (1965); Mintzberg (1979); Porter (1980, 1985)] dating back over thirty years, but little concerned with smaller enterprises. In recent years, writers increasingly have been directing their work towards the case of the small firm<sup>2</sup>, but the lack of published volumes on the subject suggests that the area of research is still very much in its infancy. Even those works that target specifically 'small' firms [*cf.* Bamberger (1983); Variyam and Kraybill (1993)] often define such businesses as having up to 500 employees. They therefore neglect the small start-ups that are under consideration in this work.

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<sup>1</sup>For the purposes of this study, 'small' refers to so-called *micro firms*, with an average of less than ten employees at first interview. See Storey's (1994, Chapter 1) discussion of the problems in agreeing upon a definition of 'small' firm.

<sup>2</sup>See, in particular, Reid (1993) and Reid, Jacobsen and Anderson (1993).

Perhaps the main problem for investigators in this area is the difficulty in gathering reliable data. Small firms are not subject to the reporting conventions of larger enterprises, which are required to make public their accounts and are often listed in various registers or directories. Therefore, information on the operations and financial performance of smaller firms is hard to come by. Establishing a sample is, in itself, not an easy task, given that there is no national register of start-up firms in Scotland. Researchers must therefore rely upon other sources<sup>3</sup> to provide them with the contact names on new entrepreneurs, or information pertaining to their businesses.

There *have* been some empirical works on the small firm such as those of Bamberger (1983) and Variyam and Kraybill (1993), but the definition of ‘small’ in these cases is rather bigger than that used in this study.<sup>4</sup> Probably the most readily comparable studies are those of Reid, resulting in Reid and Jacobsen (1988), Reid (1993) and Reid *et al* (1993). These volumes represent ground-breaking techniques for analysing small firms. They are based upon data obtained from original administered questionnaires and semi-structured interviews conducted with owner managers of Scottish firms, and provide evidence to show that small firms do indeed strive to achieve competitive advantage by employing such strategies described by Porter (1980) as cost leadership, differentiation and focus.

There are various arguments as to which *types* of strategies are the more effective. Mintzberg, for example, favours the adaptive ‘visionary’ approach, whereby the organisation is run according to a ‘mission’, decisions are reached

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<sup>3</sup>Such as, for example, Enterprise Trusts or Chambers of Commerce.

<sup>4</sup>Variyam and Kraybill (1993) derived their results from a sample of small firms with less than 500 employees. Bamberger (1983) refers to small firms as having between 1 and 499 employees.

through learning and experience and they are based on the ‘intuition’ and ‘creativity’ of key personnel.<sup>5</sup> He criticises the formal planning procedures advocated by others as being too rigid, saying that they restrict or prevent the use of judgement and intuition. Kay (1993, p.357) agrees with Mintzberg that “strategy is necessarily incremental and adaptive”, but adds that this “does not in any way imply that its evolution cannot be, or should not be, analysed, managed and controlled”.

Reid has based his work on evidence collected from small firms by speaking to them and asking what they actually do; how they run their business. In *Small Business Enterprise* (1993) he develops a ‘Porter-influenced analytical framework’ and contends that small firms can and do use formally structured strategies in the running of their organisations. Reid (1993, p.119) claims that Porter’s third strategy, “A focus strategy, aimed at the particular market segment, ... seems most likely to offer the SBE<sup>6</sup> a competitive advantage”, and that “the typical SBE ... was more concerned with devising an aggressive competitive strategy than a defensive one” [Reid (1993, p.134)]. This thesis develops further the work started by Reid in earlier years, extending the analysis to a deep and thorough treatment of micro-firm strategies.

### **1.3 Form of the thesis**

The thesis begins in Chapter 2 with an analysis of the literature on strategy specifically, new small firms in general, and recent works which examine specifically the strategies of small businesses. Appraisal of the literature leads to

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<sup>5</sup>See Mintzberg (1994).

<sup>6</sup>SBE: Small Business Enterprise.

questions which are addressed in the fieldwork, and gives rise to issues of topical importance and interest that are deemed worthy of further investigation. For example, recent innovations in the management accounting literature suggest that total quality management (TQM) systems or ISO9000 accreditation may be important to new businesses. In addition, the rapid changes and innovations in information technology over recent years have led to possibilities for its exploitation by new small firms.

All of the data used in this work were to be gathered by original fieldwork methods, so Chapter 3 discusses the generation of a sample of small firms for interview, and the design of the relevant questionnaires. It shows how Enterprise Trusts provided a stratified random sample of businesses willing to participate in the study. Two instruments were designed from scratch. The first, an administered questionnaire, was used to provide the main quantitative evidence, and enabled statistical analysis. The second questionnaire was a semi-structured interview schedule, which examined the firm's strategy processes. It formed the basis for a set of 17 detailed case studies on small business strategy.

Chapter 4 shows how the quantitative data generated by the administered questionnaire were installed onto a specially-designed computer database. It then presents and discusses the summary statistics for all 150 firms for the first two years of the study. Using cluster analysis, the firms are then divided into low, medium and high performers. The chapter ends by analysing in some detail the characteristics of each performance group, by reference to both measures of their performance, and their business strategies.

Chapters 5 and 6 constitute the largest and, in some regards, the most important section of the work. They analyse the characteristics of each performance group,



in terms of the strategies followed by those firms. These chapters draw heavily on the case study evidence, and the findings are supported by statistical data from the administered questionnaire. A total of seven propositions are developed and tested to further investigate key points of interest. These are illustrated by statistical methods such as boxplots and cross-tabulations, and are supported or rejected by chi-square test statistics for measures of association.

Chapter 7 draws together the observations from the work as a whole. It summarises the strategies followed by each performance group, and develops from these a list of prescribed strategies or courses of action that should assist a new owner-manager in achieving high performance. The work concludes with suggestions as to how business advisors can assist small firms in adhering to these prescriptions.

Supporting material to this work is held in a separate volume of five Appendices. The first contains a 'data dictionary', which defines the variables used in the database. For each question in the business strategy section of the administered questionnaire, there are several relevant variables, which add to a significant number of entries in total. The data dictionary enables the user to look up variable definitions quickly and efficiently. It gives the name of each variable, a brief description of its meaning, the database table in which it is contained<sup>7</sup>, and an additional note. This note refers to a coding system, which tells the user whether the variable is binary, categorical, a text string, or in some other form, and what the coding means.

Appendices II and III contain the questionnaire schedules used in the actual

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<sup>7</sup> In this case, 'strat', for STRATEGY table.

interviews. The administered questionnaire given is the relevant section (*viz.* Business Strategy) from the main questionnaire in Reid's Leverhulme Trust funded study. It has inserted, in addition, the summary statistics from years one and two of the study. The semi-structured questionnaire is, again, as used in the fieldwork interviews. It was this instrument from which was obtained the qualitative evidence discussed in Chapters 5 and 6.

In Appendix IV, the 17 case studies of individual firms are presented. These analyse in detail the firm's environmental scanning, its strategy formulation and implementation, and methods of evaluation and control. Of these firms, the high performers are Cases C, K and L; the medium performers are Cases B, G, H, I, J and N; and the low performers are Cases A, D, E, F, M, O, P and Q.

Finally, Appendix V contains previous (co-authored) work which is of some relevance to this study, and is referred to at various points throughout the text of this thesis. The first is a chapter in a book on intellectual property, which looks at the value of patenting to firms in the UK scientific instruments industry. The second work is a Discussion Paper which draws on data gathered for this study. It uses the methods described in Chapter 4 of this thesis to cluster firms into performance categories, and then applies econometric techniques to the data in order to discover what makes a new business start-up successful. The paper is currently under consideration by the journal *Managerial and Decision Economics*. The final inclusion in Appendix V is a paper on risk management in the venture capital industry in the UK.

## **1.4 Summary**

This introduction has set out the basic reasoning behind the undertaking of this work. It has set the study into context by examining the background of literature on business strategy, and found that there is very little recent empirical evidence on the subject of small business strategy, particularly with regard to very young micro firms and the Scottish environment. Problems of data collection were raised, and it was suggested that a major difficulty in this area was of getting the contact names of entrepreneurs willing to take part in such a study. In this regard, the author was fortunate to benefit from the good relations with the Enterprise Trust movement previously established by Reid for his earlier works.

The form of the thesis was then discussed. It starts with an analysis of early and recent literature in the relevant areas. It proceeds by describing the fieldwork methodology, including the sample and questionnaire design. The thesis then shows how a new database was constructed, and analyses the summary statistics before dividing firms into performance levels. The case study qualitative evidence is then discussed, before finally finishing with prescriptions designed for high performance.

# Chapter 2

## Strategy: from corporations to the small firm

### 2.1 Introduction

Ansoff (1965, p.5) defines strategic decisions simply as those “pertaining to the relation between the firm and its environment”. Mintzberg (1979, p.25) expands upon this description, stating that “strategy may be viewed as a mediating force between the organization and its environment. Strategy formulation therefore involves the interpretation of the environment and the development of consistent patterns in streams of organizational decisions (‘strategies’) to deal with it”. Porter (1985, p.1) agrees that “competitive strategy is the search for a favorable competitive position in an industry, the fundamental arena in which competition occurs”.

The works of Ansoff (1965), Mintzberg (1979) and Porter (1980, 1985), which look in some detail at the way in which firms develop strategies appropriate to their closely analysed environment, and then further investigate methods of implementing these strategies, are important works of their kind. They are, however, geared more towards larger organisations: those with complex hierarchies, which might include a Head Office, with a Board of Directors and several independently run subsidiaries; and those with individual departments for dealing with separate issues such as finance, marketing and personnel. Nevertheless, a study of the strategies used by small firms can only benefit from the

expertise of previous writers on the subject of strategy as a whole. By taking together the main ideas propounded by such experts, and modifying or adapting these ideas, it is possible to develop a simpler model suitable for application to the small firm, as seen for example in Reid and Jacobsen (1988) and more recently in Reid *et al* (1993).

This study commences, therefore, by putting into context in Chapter 2 the reasons for this study, with a look at previous related works in the area. Section 2.2 considers the existing literature on strategy, being concerned mainly with large, corporate enterprises. Reference is made, generally in chronological order, to the most important works over the past 30 years or so, from Ansoff's early work through the structured analyses of Porter and the adaptive approaches preferred by Mintzberg and Steiner. Technology strategy is considered as an increasingly important aspect in today's fast-changing technological world. Reference is also made to other works that provide a summary of the literature on strategy.

An interesting point that emerges from analysis of the extant literature is the wide variety of words and phrases employed by different writers on the subject, who seem unable to agree upon a standard terminology. Some of the more important words in use are given in Table 2.1, which clearly illustrates the inability of researchers to agree on a single description of strategy. As long ago as 1965, Ansoff used phrases such as 'strategic thinking' and 'strategic decisions'. Mintzberg (1979) and Steiner (1979) followed similar lines of thought, introducing the concept of 'the organisation's "mission"', and 'intuitive-anticipatory planning'. Both of these authors believe that a firm's ability to adapt to sudden changes and make judgements based on 'gut feel' are important to its decision-making capabilities.

# TERMS USED BY WRITERS ON BUSINESS STRATEGY

**Table 2.1**

Writer	Year	Term or Phrase
Ansoff	1965	Strategic Thinking Strategic Decisions
Mintzberg	1979, 1994	Strategic Apex The Organisation's 'Mission' Strategic Planning Strategic Thinking
Steiner	1979	Intuitive-Anticipatory Planning Formal Strategic Planning
Porter	1980, 1985	Competitive Strategy (Sustainable) Competitive Advantage Corporate Strategy Five Forces of Competition Value Chain/Value Channels/Linkages Cost Leadership Differentiation Focus Strategy
Johnson & Scholes	1984	Corporate Strategy Competitive/Business Strategy Developing Strategies Strategic Analysis Strategic Choice Strategic Implementation
Kay	1993	Rationalist School Emergent Strategy

With the 1980s came Porter's two seminal works on 'competitive strategy' and 'competitive advantage' [cf. Porter (1980, 1985)], and with them a wealth of new terms, including the 'five forces of competition', the 'value chain' and 'value channels'. Johnson and Scholes' (1984) work is heavily influenced by the writings of Porter in that they advocate 'strategic analysis, choice and implementation', conducted in a formal manner. And Kay (1993) divides the works on business strategy into what he calls the 'rationalist school' and those who fall under the heading of 'emergent strategy'. Clearly, no consensus has yet been reached as to which terms best captures strategic planning processes.

Section 2.3 considers strategy and the small firm.<sup>1</sup> Recent literature on small firms is used to illustrate the current theory relating to and the experience of young enterprises. This section falls under five broad headings. *Aims, Ambitions and Making Decisions* looks at the reasons for starting up new small business, the expectations held by the owner-manager, and the effects these have on the direction the firm takes. *Forward Planning* considers the need for and usefulness of having a structured business plan. *Funding Growth* discusses the various options available to firms for improving their financial situation or for financing expansion. *Information, Technology and Communications* highlights the need for firms to be aware of their external environment and competitors, and shows how new technologies can assist in the gathering of information and achieving of competitive advantage. And finally, *Quality Control and SWOT Analysis* addresses the relevance of formal systems of quality control for small firms. In

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<sup>1</sup> For an overview of the key issues affecting small firms see, for example, Storey (1994) *Understanding the Small Business Sector*.

addition, formal techniques for assessing the internal and external environment are considered.

## **2.2 Corporate Strategy**

In the preface to his 1965 work, Ansoff (1965, p.vii) talks of the *management* of a business entity as being “the active process of determining and guiding the course of a firm toward its objectives” by means of many interrelated activities, including “analysis, decisions, communication, leadership, motivation, measurement and control”. He singles out decision making as being the key activity, and focuses on the arena in which strategic decisions are made. They are, he says, “primarily concerned with external, rather than internal, problems of the firm and specifically with selection of the product-mix which the firm will produce and the markets to which it will sell” [Ansoff (1965, p.5)]. An awareness of the environment in which the firm operates is therefore vitally important when it comes to making decisions about where the firm should be aiming to go next.

Ansoff remarks on the difficulties that may arise when daily operating problems impede the process of strategic thinking. He argues that a firm must be organised in such a way that a “proper balance of attention between the strategic and operating decisions” can be achieved, but admits that this is, in practice, difficult [Ansoff (1965, p.9)]. The problem is, as he sees it, that urgent decisions which have to be made on a day-to-day basis take priority over more time-consuming strategic decisions, whose impact will only become apparent over a longer period of time.

In order to formulate strategies to achieve certain objectives, the firm as an entity must obviously start by identifying those objectives. This is not always an easy



task: to set objectives, decision-makers are required. Who should they be: the owners, or shareholders; management; or a combination of people with an interest in the firm? Long-term survival, the development of a loyal customer base or a sense of social responsibility could all be equally important to an organisation, if not more so than, for example, profit maximisation.<sup>2</sup> Ansoff (1965, p.39) makes the assumption that “the business firm does have objectives which are different and distinct from individual objectives of the participants”. This may well be the case in a large firm with many separate departments and a long track record in their field, where perhaps the original objectives of the firm have altered over time as an increasing number of specialist ‘outsiders’ are brought in to help deal with the increasing complexity of the organisation. He accepts that individuals within an organisation may still be able to influence the objectives of the firm as a whole, but states also that “objectives for an institution known as a business firm can be inferred from its relationship to the environment, from its internal structure, from the functions it performs, and from its past history” [Ansoff (1965, p.39)].

Bridge and Dodds (1978, p.19) analyse corporate objectives, decisions and plans, saying that “whether it pursues growth, or some other objective, the modern large business firm has to respond not only to changes in the environment and to pressures generated internally, it also anticipates change, and influences its own environment and accordingly needs a decision-taking capability which can meet these wide-ranging demands”. They agree with Ansoff that strategic decision-making occurs at senior management level, reflecting their importance.

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<sup>2</sup> For example, in ‘not-for-profit’ organisations such as medical, educational or welfare institutions, where the owner-manager feels an obligation to serve society rather than add to his own personal wealth. See Ansoff (1965) Chapter 4: ‘A Practical System of Objectives’.

The achievement of growth is seen by Bridge and Dodds to be one of the main objectives of an organisation. They admit that growth may come about through diversification of, for example, the product line, or by following Ansoff's preference for a 'product mission', which "has many different needs to be satisfied, each of which may require a different product" [Bridge and Dodds (1978, p.103)]. However, growth need not necessarily occur through diversification, but can be achieved, they argue, by using "*market penetration, market development and product development strategies*" [Bridge and Dodds (1978, p.103)]. The first, market penetration, involves trying to increase the volume of sales, both by selling more to current customers, and by attracting new buyers from elsewhere. Market development might involve minor modifications to existing products, but is principally devoted to "the seeking of new mission requirements which can be served by the present production line" [Bridge and Dodds (1978, p.103)]. Product development requires no change in mission, but instead involves making alterations or improvements to existing products.

The *Strategic Apex* is defined by Mintzberg (1979, p.25) as being those persons who are "charged with ensuring that the organization serve its mission in an effective way, and also that it serve the needs of those people who control or otherwise have power over the organization".<sup>3</sup> As such, they are bound by three main duties which Mintzberg identifies as being: direct supervision; the management of the organisation's relationship with its environment; and the development of the organisation's strategy. The overall role of the *Strategic Apex*

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<sup>3</sup> See, for example, Mintzberg (1979) chapter 2 where he distinguishes between the 'Five Basic Parts of the Organization': the operating core, the strategic apex, the middle line, the technostructure, and support staff.

is, he considers, to “search for effective ways to carry out the organization’s ‘mission’ (i.e. its production of basic products and services)” [Mintzberg (1979, p.26)].

The structural configuration<sup>4</sup> for which the strategic apex is the most important is the *simple structure*, which typically “has little or no technostructure, few support staffers, a loose division of labor, minimal differentiation among its units, and a small managerial hierarchy” [Mintzberg (1979, p.306)]. This corresponds closely to Williamson’s (1975, p.49) ‘simple hierarchy’. This is headed by a ‘peak coordinator’, who not only enjoys “the power which authority and expertise accord him”, but also finds that “having more complete information gives him strategic advantage over everyone else” [Williamson (1975, pp.53-54)]. Although the most obvious example of a simple structured business is the small entrepreneurial firm, larger firms can also be forced into such forms, claims Mintzberg, through, for example, crises requiring a fast, coordinated response, which “puts power in the hands of the chief executive, and serves to reduce the degree of bureaucratization as well” [Mintzberg (1979, p.308)]. Strategy formulation in a simple structure lies with the chief executive (*cf.* owner manager in SBE) and therefore, according to Mintzberg (1979, p.307) tends to be “highly intuitive and nonanalytical, often thriving on uncertainty and oriented to the aggressive search for opportunities”.

Steiner (1979, p.3) claims that “strategic planning is inextricably interwoven into the entire fabric of management”. He subdivides management into two distinct categories: *strategic*, where all decisions are made at the top of the organisational

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<sup>4</sup> Mintzberg (1979, p.301) identifies five possible structural configurations: simple structure, machine bureaucracy, professional bureaucracy, divisionalized form, adhocracy.

hierarchy; and *operational*, which relates to “everything else”. Strategic *planning* is therefore seen as an aid to strategic management. He identifies two alternative methods of formulating strategic plans. First, there is what he calls ‘Intuitive-Anticipatory Planning’, which is commonly “in the brain of one person ... has a comparatively short time horizon and reaction time ... is based upon the past experience, the ‘gut’ feel, the judgment, and the reflective thinking of a manager” [Steiner (1979, p.8)]. In other words it is the sort of planning favoured by Mintzberg [discussed further in section 2.3]. This is fine, says Steiner, so long as the business is managed by “intuitive geniuses”, but these are few and far between, and judgements made on intuition alone may not always be correct.

Second, Steiner outlines ‘Formal Strategic Planning’, which is “organized and developed on the basis of a set of procedures ... is explicit in the sense that people know what is going on ... is research based ... involves the participation of many people ... and the result of the entire endeavour is a written set of plans” [Steiner (1979, p.10)]. Although conflict can arise in organisations where these two different methods of planning meet, Steiner (1979, p.10) remarks that “they can and should compliment one another”. As he explains, “formal planning cannot be really effective unless managers at all levels inject their judgment and intuition into the planning process” [Steiner (1979, p.10)].

Michael Porter is well-known for his work on competitive strategy and is often referred to by writers on the subject. In his analyses of industries [*cf.* Porter (1980, 1985)] he distinguishes between what he calls the ‘Five Forces of Competition’. These are: the bargaining power of *suppliers*; the bargaining power of *buyers*; the threat of potential new *entrants* to the market; the threat of new *substitute* products; and the rivalry that already exists among existing *competitors* in the

industry. An awareness and understanding of these forces, which govern the attractiveness of any industry, is fundamental if the firm is to exploit the industry to its greatest potential. The five forces just outlined “determine industry profitability because they influence the prices, costs and required investment of firms in an industry - the elements of return on investment” [Porter (1985, p.5)]. As he also states, “Competitive strategy must grow out of a sophisticated understanding of the rules of competition that determine an industry’s attractiveness” and the ultimate aim of competitive strategy must therefore be “to cope with and, ideally, to change those rules in the firm’s favor” [Porter (1985, p.4)]. Once the firm has gained a competitive advantage over its rivals, then the onus is on it to *sustain* this advantage.

Porter defines three generic strategies which may be followed in order to achieve a competitive advantage over one’s rivals: *cost leadership*, where a firm aims to be the lowest-cost producer in an industry; *differentiation*, where a firm aims to establish a product with some kind of unique attribute, something slightly different to that of its rivals and which is novel to the market in which it operates; and *focus*, whereby a firm selects a niche in the market and targets the customers in it specifically, to the exclusion of all others. He further breaks down focus into *cost focus* versus *differentiation focus*, and suggests that firms may need to alter their approach to targeting customers depending on the specific requirements of individual customers within the target markets. Whereas a cheaper generic product may be more attractive to some [*cf. cost focus*], others may be persuaded to purchase because of a unique feature or novelty value of the product [*cf. differentiation focus*].

Porter's three strategies may be applied to any firm in any industry, although, depending on the industry, one may prove to be more important than the others. For example, "in some industries, industry structure or the strategies of competitors eliminate the possibility of achieving one or more of the generic strategies, [and] occasionally no feasible way for one firm to gain a significant cost advantage exists, for example, because several firms are equally placed with respect to scale economies, access to raw materials, or other cost drivers" [Porter (1985, p.21)]. His work of 1985 describes some methods of actually implementing the outlined strategies within an organisation, and then of "sustaining superior performance" within the firm's market sector, as compared to its rivals.

The *value chain* [see Figures 2.1a and 2.1b] is a method developed by Porter of analysing the sources of competitive advantage. It assumes that competitive advantage results from a combination of the many different activities a firm pursues during the course of its business, rather than coming from one individual source. Primary activities are concerned with the actual production, marketing, delivery and after-sale care and servicing of the product. Support activities allow the primary activities to occur by providing the necessary inputs and infrastructure. Porter further develops a *value system*, which covers the environment in which the firm operates whereas the *value chain* relates to the individual firm within the system. Products pass through many *value channels* and *value chains*, for example, the processes of suppliers and buyers. As they move through the system from supplier to buyer, argues Porter, the products add to the overall *value chain* of the firm. This *value chain* he describes as being "a reflection of its [i.e. the firm's] history, its strategy, its approach to implementing its strategy, and the underlying economics of the activities themselves" [Porter (1985, p.36)].

Developing over time, it comes to represent the worth of the business, and is tied up in both tangible and intangible assets, which together add to the overall value of the business.

Figure 2.1a shows the concept of the value chain in its simplest form: primary activities aided by support activities add to a firm's overall value. Porter defines the value activities as follows: "Primary activities ... are the activities involved in the physical creation of the product and its sale and transfer to the buyer as well as after sale assistance ... Support activities support the primary activities and each other by providing purchased inputs, technology, human resources, and various firmwide functions" [Porter (1985, p.38)]. Figure 2.1b shows the nine generic value activities and the place they hold in the value chain. As Porter (1985, p.61) states, "an organizational structure that corresponds to the value chain will improve a firm's ability to create and sustain competitive advantage", and he describes in some detail how this can be achieved.<sup>5</sup>

Johnson and Scholes (1984, pp.9-10) break strategies down into three levels. First, they define the *corporate* level, which is "concerned with what sorts of businesses the company, as a whole, should be in". Second, there is *competitive* or *business* strategy, which is "about how to compete in a particular market". Third, they define *operational* strategies as being those concerned with "how the different functions of the enterprise - marketing, finance, manufacturing and so on - contribute to the other levels of strategy". They separate strategy from planning, stating that the latter assists in "the *adaptation* of the organisation to its environment"; it provides an "*integration* role ... acting as a communication

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<sup>5</sup> See Porter (1985) Chapter 2: 'The Value Chain and Competitive Advantage' for further explanation.

THE VALUE CHAIN

Figure 1a

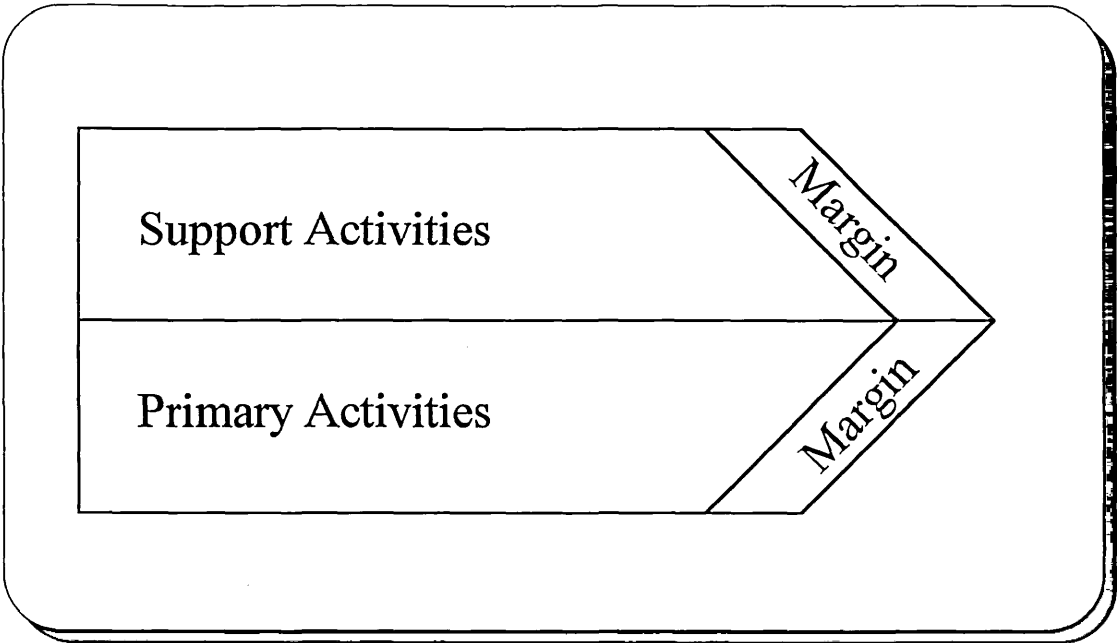
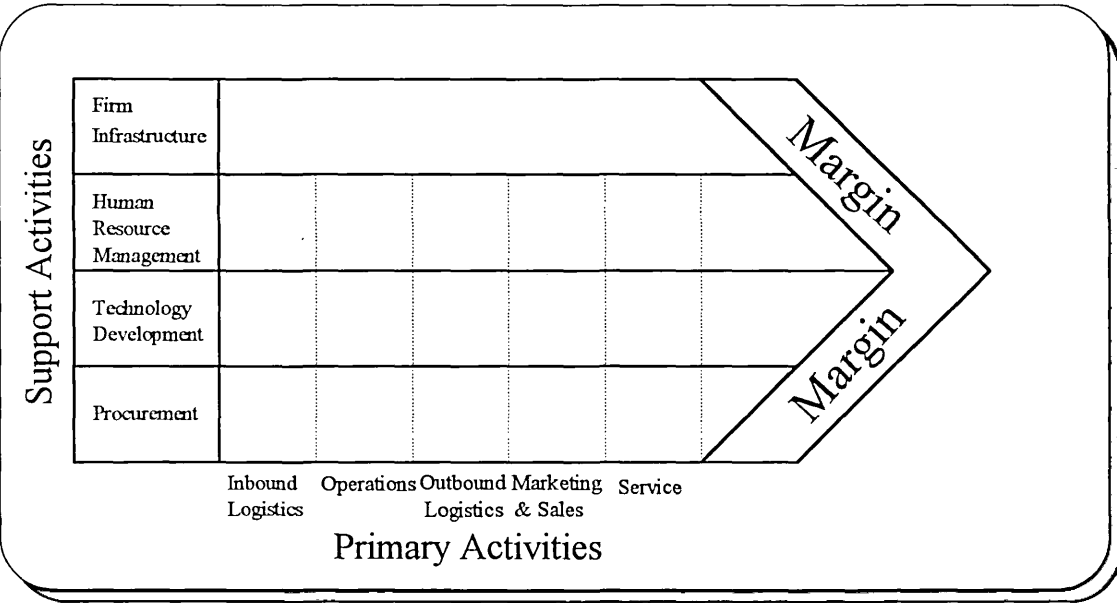


Figure 1b



**Notes:** Figure 1a is a greatly simplified version of Porter's value chain.  
Figure 1b is a more detailed diagram which identifies the nine value activities which together add to the overall value of the firm.

*Based on Porter (1985)*



channel”; and it also provides “a *control* mechanism to monitor the performance of parts of the organisation”. Corporate planning is seen by them to be “an aid to, rather than ... the means of, strategic planning” [Johnson and Scholes (1984, p.32)].

The authors then concentrate on the strategic environment, and note the importance of understanding the *nature* of this environment through detailed *strategic analysis*. One method of analysing this is, they say, by use of Porter’s *five forces* model. Their work relates closely to that of Porter in that they advocate “an analysis of the nature of the environment” where “the aim is to understand the environment in such a way as to generate a credible strategy in relation to the main forces in that environment” [Johnson and Scholes (1984, p.69)]. They draw heavily upon the ideas behind Porter’s *five forces* model and develop these to “provide a framework by which to understand the influences of the environment on organisations and their strategies” [Johnson and Scholes (1984, p.82)]. Amongst factors which must be considered when analysing the environment are influences on the firm of such factors as the economic climate, the labour market, government legislation and technological innovations.<sup>6</sup>

Another method of formal environmental analysis is to examine the Strengths, Weaknesses, Opportunities and Threats of and to the business, carrying out a so-called ‘SWOT’ analysis. This analysis results from a detailed assessment of the resources of the business and is, say Johnson and Scholes (1984, p.110), “useful as a basis against which to judge future courses of action”. SWOT analysis is,

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<sup>6</sup> See Johnson and Scholes (1984) Chapter 3: ‘The Strategic Environment’, for further discussion on understanding the environment.

however, only one of several variations on this theme, and is a formal method of structuring the kinds of analyses that managers have used for years.

For example, Steiner (1979, p.20) introduces the 'WOTS UP' analysis which is, he believes, "a critical step in the planning process" given that "a cardinal purpose of strategic planning is to discover future opportunities and threats so as to make plans to exploit or avoid them". In addition, Weihrich (1982, p.27) talks of the 'TOWS' matrix which he calls "a conceptual framework for a systematic analysis that facilitates matching the external threats and opportunities with the internal strengths and weaknesses of the organisation". And Kay (1993, p.358), more recently, has also recognised the usefulness of SWOT analysis. It is, he explains, "simply a list" which, although it "conveys no information in itself ... is a way of helping us to think about the information we already have". Managers, therefore, should find that a detailed analysis, of the sort described above, leads to a better understanding of the firm's environment, and its own internal strengths and weaknesses, thereby facilitating decision-making for future development.

The second stage of strategic management which follows on from strategic analysis is, according to Johnson and Scholes, *strategic choice*. This involves the generation of various strategic options, comparison and evaluation of these options, and choice of the most suitable strategy for the organisation. Johnson and Scholes argue that, because a firm must be continually changing and adapting to its environment, the generation of strategic options should be of prime concern. They support the notion of *developing strategies*, which combine possible *directions* for the firm with *methods* of achieving such development. Once a variety of options has been developed, the firm must then evaluate each option on its merits. This might involve using such techniques as profitability analysis, breakeven analysis,

and an assessment of competitors' reactions, amongst many others.<sup>7</sup> Finally, under strategic choice, comes selection of the most suitable strategy which, compared with all other possibilities, best meets the firm's objectives. Strategic choice is, state Johnson and Scholes (1984, p.167), "concerned with decisions about an organisation's future and the way it needs to respond to the many pressures and influences identified in the strategic analysis". It is, they believe, in many ways "the core of corporate strategy".

The third and final stage of strategic management is then the *implementation* of the selected strategy. This must take into account the allocation of resources, the structural form of the organisation, and the people and systems already in place. To implement a strategy, the resource requirements of so doing must be identified. Resources can be of several types. They might be *physical*, such as plant and materials; *human*, such as staff or management; or *financial*, such as debt or equity finance. Costs associated with resource allocation should be met out of the budget for implementation of the strategy, and care should be taken when changing strategy that the new one fits in with existing or available resources and that the changeover is made as smoothly as possible. In terms of organisation, management should try not to disrupt too severely the existing hierarchies within the firm. Authority may need to be delegated as the organisation grows and changes, but again this should be done in such a way so as not to upset existing employees or alter too drastically systems already in place.

The authors recognise that "there is little point in developing strategies if there is no clear, long term idea of how they are to be financed" [Johnson and Scholes

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<sup>7</sup> See Johnson and Scholes (1984) Chapter 8: 'Evaluation and Selection of Strategies', for a description of various assessment techniques.

(1984, p.260)]. Therefore, they suggest that a financial strategy should be developed that sets out in detail how new strategies are to be funded. Johnson and Scholes propose several key issues that require consideration when developing financial strategies. These include: cash and capital budgeting; whether projects should be financed from retained earnings or loan capital; how to finance an increase in working capital; an examination of the sourcing of funds; deciding on acceptable levels of debt; what dividend policy to follow; asset management; and the deployment of funds *within* the enterprise.<sup>8</sup>

There are several tools available to help management make decisions on suitable financial strategies, just as there are for any other strategy. Johnson and Scholes suggest various methods including, for example: ranking strategic options based on specific criteria; using decision trees which progressively eliminate options; constructing an opportunity analysis matrix to assess options against factors relating to the future environment, company resources and company values; and gap analysis, to identify shortfalls.<sup>9</sup> The use of computer spreadsheets and statistical packages can greatly facilitate such operations, in terms of speed and the easy generation of different possible scenarios.

People are all important in an organisation, and maintaining harmonious working relations is vital for improving productivity and business image: “The performance of people, and the resultant success or failure of strategic implementation is determined by a number of factors”, including “the extent to which people have the capability to perform the necessary tasks, are willing to provide sufficient effort

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<sup>8</sup> See Johnson and Scholes (1984, pp.260-261) for a discussion on Financial Strategy.

<sup>9</sup> See Johnson and Scholes (1984) Chapter 8: ‘Evaluation and Selection of Strategies’, for more examples and further explanation.

and the degree of satisfaction which they can obtain from their jobs” [Johnson and Scholes (1984, p.310)]. It is suggested that monitoring and control procedures, along with information systems, be put in place, and reward systems introduced to encourage employee cooperation and participation in strategic change. Analysis and choice, claim Johnson and Scholes, are both important aspects of strategic management but, they conclude, “it is the skill with which managers (and others) actually implement strategic change which determines the success or failure of strategy” [Johnson and Scholes (1984, p.338)].

Porter’s more recent work with Millar [*cf.* Porter and Millar (1991)] looks at the impact of information technology on competitive advantage. Information technology is defined as having to be “conceived of broadly to encompass the information that businesses create and use as well as a wide spectrum of increasingly convergent and linked technologies that process the information” [Porter and Millar (1991, p.33)]. Their definition covers a wide variety of items ranging from personal computers to communications technologies and factory automation. They argue that new technology affects competition in three different ways: it “changes industry structure”, therefore altering the rules of competition outlined in Porter’s *five forces* model; it “creates competitive advantage by giving companies new ways to outperform their rivals”; and it “spawns whole new businesses, often from within a company’s existing operations” [Porter and Millar (1991, p.34)].

Recalling the *value chain* from Porter’s previous work, Porter and Millar (1991, p.35) state that “information technology is permeating [it] at every point, transforming the way value activities are performed and the nature of the linkages among them”. Figure 2.2 shows that IT can be relevant to every value activity.

The primary activities, as discussed earlier, are to do with the production, sale and after-care of the product. Thus, in a high-technology firm, these might include an automated warehouse, with flexible manufacturing, automated order processing, telemarketing and computer scheduling and routing of repair trucks. The support activities, which assist primary activities, in such a firm could encompass planning models, automated personnel scheduling, computer aided design technologies and the on-line procurement of parts.

Integrating information technology into an existing system can facilitate the achieving of competitive advantage. For example, it has already been mentioned that one method of achieving competitive advantage is through cost leadership. Information technology can reduce costs in an organisation: computers have greatly increased the speed and efficiency of transactions; and automated machinery has taken over from human labour, thus lowering the wage bill considerably amongst firms in some industries.

The second method of achieving competitive advantage is through product differentiation. Information technology has made customisation an easier process: the ability to adapt and produce exactly what the customer needs, or to establish a product unique in its market, is one way of creating competitive advantage. Laptop computers are enabling increased mobility and flexibility in all kinds of firms, allowing staff to take their own PC along to a customer, input details and requirements, and print off estimates or transfer data by electronic mail.<sup>10</sup>

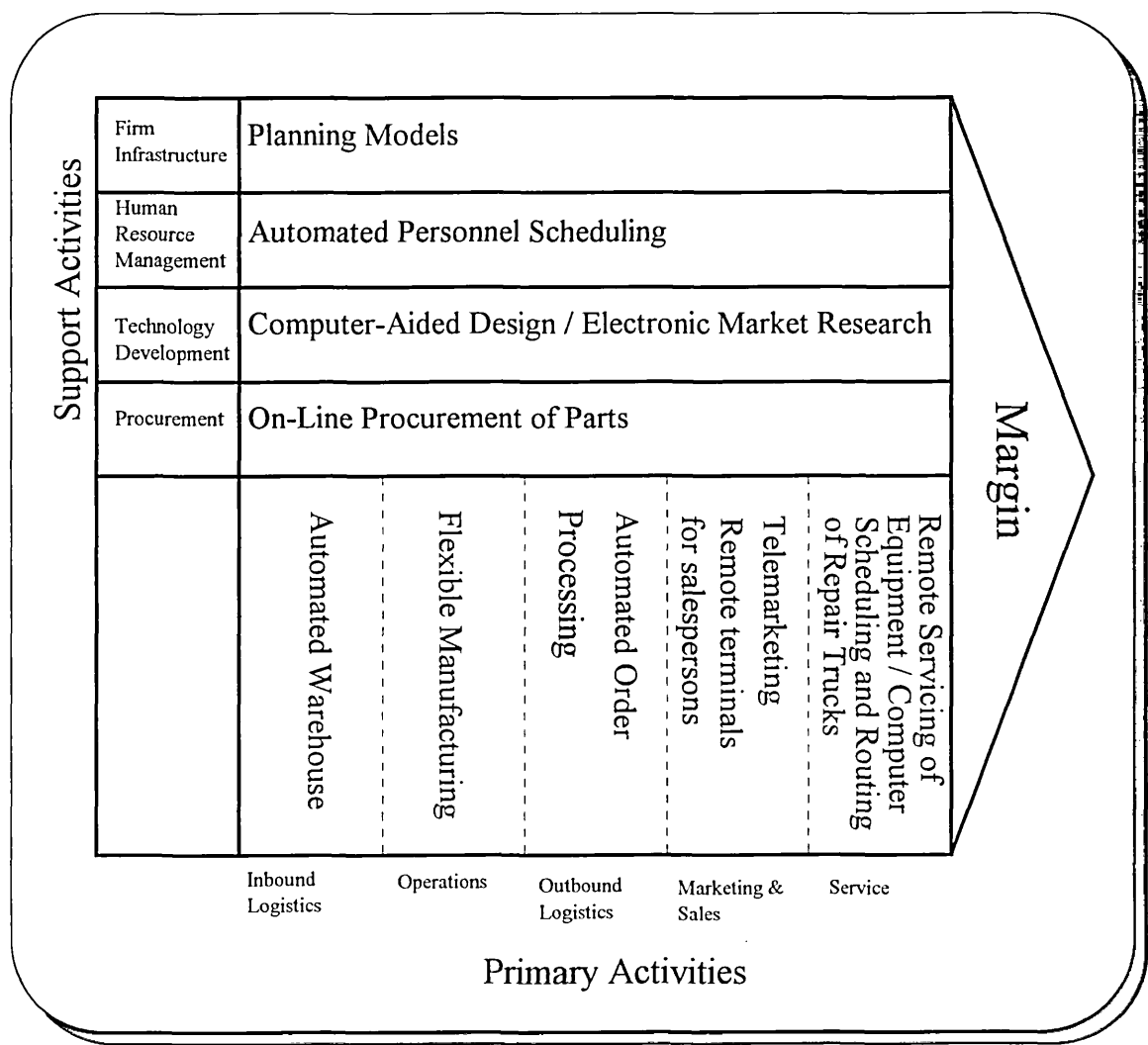
Porter and Millar (1991, p.44) conclude by saying that “companies that

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<sup>10</sup> For additional examples of the availability of IT, try browsing through a computer products magazine, where the wealth of material on offer is staggering: from hardware such as multimedia notepads, cordless mice and text scanners; through to software such as CAD (computer aided design) drawing tools, language translation assistants and business productivity software [*cf. Misco Computer Products* catalogue, March 1996].

# THE VALUE CHAIN PERMEATED BY INFORMATION TECHNOLOGY

Figure 2.2



**Notes:** The diagram shows a typical value chain for a firm that relies heavily on information technology in the running of its business. Technological activities which may add to overall value are individually identified.

*Source: Porter and Millar (1991, p.37) How information gives you competitive advantage.*

anticipate the power of information technology will be in control of events. Companies that do not respond will be forced to accept changes that others initiate and will find themselves at a competitive disadvantage". The examples given above of information technology are available to any firm who wants and can afford them, as well as to its competitors. Thus it can be seen that information technology and the rapidity with which it is changing, should become an important consideration in shaping the strategy of an organisation seeking to achieve competitive advantage.

In the introduction to a volume of collected papers, Dodgson (1989, p.5) states that "technology strategy is important as it needs to complement overall company strategy: encompassing business, marketing, manufacturing, personnel, investment and financial strategy". In the same book, Pavitt *et al* report on the drawbacks of Porter's works and attempt to "fill the gaps" with their analyses of high-technology firms. For example, they criticise Porter for failing to explore the varied technological threats and opportunities faced by firms in different sectors, and for not analysing the problems faced by such firms when implementing new technologies. They then go on themselves to analyse in some depth these opportunities, threats and the differentiation that is evident between sectors, thereby performing the sort of SWOT analysis that has been discussed earlier.

Also in Dodgson's (1989) volume, Thomas and Miles (1989, p.95) describe the advantages to be gained from new interactive services, which are "computer-mediated ... rely on text or simple graphics to convey information, and ... permit users to have an influence on data delivered through a telecommunications system". Firms with a strong information technology base can use these new systems to capture their niche market and keep in close contact with their customer



base, for example, using the world wide web for advertising, and the internet for taking orders and transferring other relevant data at high speed. As Thomas and Miles (1989, p.107) point out, “niche markets are often (or becoming) international in order to achieve economies of scale ... or because the relevant information technology is inherently regional or global”. Information technology provides a fast and cheap way of communicating with the customer and of implementing a “niche marketing strategy” which, they say, “requires the identification of a suitably encapsulated area which is not already over-occupied, and the maintenance of extremely close cooperation with customers” [Thomas and Miles (1989, p.107)].

Dodgson and Rothwell (1989) argue that small and medium-sized firms need to develop strategies for technology. They claim that “a key defining criterion of future growth potential is the existence of a coherent strategy for technological development” [Dodgson and Rothwell (1989, p.153)]. Their study is based on a sample of “exceptional” companies which were “highly technologically advanced”, and is interesting in that it shows the potential that exists for firms in high technology sectors.

Dodgson’s (1989) conclusion to the book neatly sums up the opportunities offered by having a technology strategy. Leading firms with extremely diverse products have all, he says, “been shown to possess technology strategies” [Dodgson (1989, p.219)]. This, he continues, is because their products “depend upon technology for a number of important characteristics ... which differentiate them from competing products in the market place”, through which competitive advantage is achieved. He ends by saying that “it is hoped that one of the main contributions [in the edited volume] is the provision of empirical evidence showing

the value for many firms in developing and using an effective technology strategy” [Dodgson (1989, p.227)].

Sarathy (1994) investigates global strategy in service industries. He remarks upon the increasing importance of services worldwide, and the differences in strategies applied to firms in service industries compared to those in the supply of goods industries. He notes in particular the importance of technology in the delivery of the service. Information technology is, he states, “a critical element of service delivery [which] permits time and space shifting of the service, allowing service delivery without the server being present ... it reduces the extent and level of interaction between service provider and customer, reducing the likelihood of customer dissatisfaction with perceived mistreatment and consequent defection ... [and it] can also reduce variation in service quality, as machines replace human beings as servers” [Sarathy (1994, p.122)]. His findings support those of the previously cited works on technology, which claim that information technology will prove to be a key factor in making successful firms of the future.

Kay (1993) divides the writings on business strategy into two distinct schools of thought. The first of these he entitles the *rationalist school*, which considers “the definition of the objectives of the firm as a key element in strategy formulation” [Kay (1993, p.345)]. This conventional approach to strategic thinking, based on a formal analysis, formulation and implementation of strategy, is now, according to Kay, “unfashionable”, although he admits its dominance persists. Kay (1993, p.354) criticises strongly the rationalist school writings, claiming that with them “dissatisfaction is widespread” and that this dissatisfaction “centres ... around issues of implementation”. “If strategy is nothing more than a vision”, he elucidates, “then it is hardly surprising that it seems easy to formulate strategy and

hard to implement it” [Kay (1993, p.355)]. However, what Kay does not admit is that those firms that choose these difficult courses of action (*viz.* formal analysis, strategy formulation and implementation), and who work hard to succeed at them, might also be amongst the higher performing businesses.

The second of Kay’s schools of thought concerns *emergent strategy*. He notes [Kay (1993, p.356)] that “successful firms often seem to have achieved their position without going through the processes of analysis, formulation, and implementation that the rationalist school implies”. Kay (1993, p.357) defines emergent strategy, based on his reading of work by Mintzberg, as “the identification of relatively systematic patterns of behaviour in what the organization actually does”. Given that firms appear, in practice, to use an adaptive method of strategy formulation, why then, wonders Kay, are the methods advocated by the rationalist school still so popular? The answer, he proposes, is that “people study and analyse strategy because they want to know what to do” [Kay (1993, p.357)]. Furthermore, rationalist strategy offers managers “a process which they can at least partially control”, even though it is at once both “necessarily incremental and adaptive”.

Kay (1993, p.33) describes the most important objectives of commercial relationships as being “co-operation (joint activity towards a shared goal), co-ordination (the need for mutually consistent responses), and differentiation (the avoidance of mutually incompatible activities)”. Believing that game theory can help us to understand such relationships, he cites the Prisoner’s Dilemma as being a particularly helpful model. The example is of two separated prisoners. Each, depending on the responses he gives under questioning, and unaware of the responses of the other, will either go free (if he, and only he, confesses), will spend

maybe seven years in jail (if both confess), or will spend ten years in jail (if the other confesses and he does not). The optimal decision, with perfect information, is for both to say nothing, and expect a light charge (of perhaps one year) for a lesser offence, as there is no firm evidence on which to convict; but, given that they cannot trust the other to do the same, and fearing a ten-year sentence, they are most likely both to confess, and will therefore receive the seven-year sentence. The various possible outcomes of such a game can be shown on a pay-off matrix.<sup>11</sup>

When applied to a business context, the problem of sharing information can be linked to that of the two prisoners. As Kay (1993, p.36) explains, “typically, the best overall outcome, both collectively and individually, is achieved by free and frank exchange of information; yet there are almost always gains to be made by withholding part of the picture” [cf. Reid, Terry & Smith (1997)]. He gives further examples of the Prisoner’s Dilemma that we all encounter in our daily lives, both socially and in business, and concludes that we are all “driven to select an outcome that everyone recognizes as inferior” [Kay (1993, p.48)]. One of the key tasks of management therefore, he remarks, must be to structure situations so as to minimise the risk of these problems arising.

A recent work of Mintzberg (1994, p.107) analyses what he calls “the Fall and Rise of Strategic Planning”, claiming that “*Strategic Planning* is not *Strategic Thinking*” and that “the most successful strategies are visions, not plans”. He argues that only when a business develops a comprehension of this difference can they return to “what the strategy-making process should be”. This, he argues, should be “capturing what the manager learns from all sources ... and then

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<sup>11</sup> See Kay (1993) Chapter 3: ‘Co-operation and Co-ordination’ for further examples and clarification.

synthesizing that learning into a vision of the direction that the business should pursue” [Mintzberg (1994, p.107)].

He favours strategic thinking over the planning and “analytical techniques” preferred by Porter. Strategic thinking, he says, involves “intuition” and “creativity”, resulting in “an integrated perspective of the enterprise” [Mintzberg (1994, p.108)]. These perspectives evolve through learning and experience and, he argues, “must be free to appear at any time and at any place in the organization” [Mintzberg (1994, p.108)]. Formal planning is, for Mintzberg, too rigid in its structure, often based on previous strategies or copied from current ones, and lacking any opening for judgement or intuition when it comes to problem solving and decision making.

The drawbacks of strategic planning are further analysed and Mintzberg (1994, p.110) chooses here to criticise Ansoff (1965, p.44) for his remark that “we shall refer to the period for which the firm is able to construct forecasts with an accuracy of, say, plus or minus 20 percent as the *planning horizon* of the firm”. Mintzberg argues that it is impossible for any company to say for how far ahead it can forecast with such a given accuracy. The company has no control over external factors such as new government legislation or increases in the rate of interest, and is not in a position to predict such influences.

The over-reliance by management on so-called “hard data” (for example, accounting statements, market research reports and opinion polls) also falls under criticism by Mintzberg. The information this gives is, by its very nature, more quantitative than qualitative, and therefore tends to miss “important nuances”. He points out that many previous studies have shown that “the most effective managers rely on some of the softest forms of information, including gossip,

hearsay, and various other intangible scraps of information” [Mintzberg (1994, p.111)].

Mintzberg criticises another of Porter’s ideas, saying that artificial intelligence and expert systems do not in fact improve methods of dealing with information overload. He accepts that formal systems have the capacity to *process* more information, but argues that “they could never *internalize* it, *comprehend* it, *synthesize* it” [Mintzberg (1979, p.111)]. Again, his argument stems from the fact that information technology can only do what it has been programmed to do. It “will never be able to forecast discontinuities, inform detached managers, or create novel strategies”, he adds.

Mintzberg, however, is not entirely opposed to the existence of planning in the workplace. Although he does not believe that it can generate strategies, he is of the opinion that, “given viable strategies, it can program them [and] make them operational” [Mintzberg (1979, p.112)]. Formal written plans are useful in attracting outsiders to the business, perhaps financial backers. Planning is useful too, thinks Mintzberg (1979, p.113), for “coordination, to ensure that everyone in the organization pulls in the same direction”. But although he sees a need for “people to bring order to ... management” and to “challenge the conventions that managers and especially their organizations develop”, he claims that past experience of strategic planning has demonstrated “the need to loosen up the process of strategy making rather than trying to seal it off by arbitrary formalization” [Mintzberg (1979, p.114)].

The discussion above of the literature on strategy has looked at those works that were written particularly with large corporations in mind. For the purposes of this thesis, two considerations arise. First, the majority of the works above are based

on little or no specific empirical analysis. Instead they often rely on concepts adapted from earlier studies of industrial organisation. For example, Porter (1980, 1985) suggests that focusing on competition is important, and comes up with a whole gamut of concepts such as *the Five Forces of Competition*, *Cost and Differentiation Focus* and the *Value Chain*, all of which seem plausible and sensible enough strategies and organisational characteristics in themselves; but, rather than develop ideas from his own direct observation of firm behaviour, Porter forms his analysis using the works of others.

Johnson and Scholes (1984) rely heavily upon Porter's work and similarly advocate formal strategic analysis, choice and implementation, but with little original evidence to support their theories. Mintzberg (1979) takes an opposing view as to the kinds of strategic planning that may or may not be successful, coming down in favour of less formal practices. For example, he suggests that to hold a 'vision' as a strategy is by far the best method, but does not support this assumption with any real-life examples.

The second consideration from the standpoint of this work is whether or not the theories about large organisations can be equally applied to the small firm. Although the focus of these writings is not specifically on small firms, they are considered at numerous points. For example, Mintzberg (1979) equates his 'simple structure' to the small entrepreneurial firm, without seeming to acknowledge that some such firms can have extremely complex organisational forms, despite their small size. And Porter has written about businesses in fragmented industries which are typically the types of markets in which small firms

compete. However, again, there is still a lack of empirical support for the theories generated.<sup>12</sup>

This section has aimed to introduce the reader to the general works on business strategy. Further enlightenment on this topic can be gained from reading, for example, Dyson's selected works on strategic planning<sup>13</sup>, the work of Mintzberg and Quinn<sup>14</sup>, or the recent work by Kay.<sup>15</sup> As was mentioned previously, however, the literature thus far reviewed has tended to concentrate on the experience of larger corporate firms. The following section aims to redress the balance by looking at the recent and emerging literature on business planning and strategy, as it relates to small firms.

### **2.3 Strategy and the Small Firm**

Section 2.2 concentrated mainly on the literature concerning the strategies of large firms. Until fairly recently, little attention had been paid to strategies in smaller firms; perhaps because it was thought that such firms were unlikely to participate in a formal planning process. Gathering empirical evidence on strategy formulation in small firms is also more difficult than for large firms. There is now, however, a growing literature, both theoretical and empirical, which discusses strategy and the small firm. It is to this body of evidence that section 2.3 appeals, whilst taking note also of the growing importance of information technology across all sectors,

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<sup>12</sup> Although Porter *has* applied his work to some illustrative case studies [Porter (1983)], the sample size used is not large enough to permit testing by statistical or econometric methods.

<sup>13</sup> See Dyson (1990, p.1) which draws together a range of papers with an aim to "introduce and explore the range of models and analytical techniques which are available to support the strategic planning process".

<sup>14</sup> See Mintzberg and Quinn (1991): *The Strategy Process*.

<sup>15</sup> See Kay (1993) Chapter 21: 'A Brief History of Business Strategy', for a helpful review of thought on Business Strategy.



and to all firms, no matter what their size.

The section is sub-divided under five headings, which reflect the existing literature in this area, and is organised to highlight the important issues surrounding strategic management for the small firm. The first, *Aims, Ambitions and Making Decisions*, assumes that the direction a small firm will follow is closely linked to the personal goals of the owner-manager. *Forward Planning* discusses the increasing emphasis on preparing long-term plans, recommended particularly by enterprise support bodies and banks. The question of *Funding Growth* has perhaps received the most attention by academics researching small firms, and this section summarises a sample of the findings. *Information, Technology and Communications* investigates the growing importance of new technology, and shows how it can be implemented in small firms to assist them in information gathering and communications, or for product differentiation and attacking new niches. Finally, *Quality Control and SWOT Analysis* are linked together as being management practices which can assist the business in strategically attacking or defending niche markets.

#### *Aims, Ambitions and Making Decisions*

Decision making within very small firms is often necessarily closely linked to the personal aspirations of the owner manager: "According to strategic theory", says Bamberger (1983, p.25), strategic decisions of a firm are "determined by the flow of information from the environment and the internal capability of the company and by the managers' values". The objectives of a small firm are thus similar or equal to the objectives of the owner manager, so much so that the "implicit image that the manager has of the firm's future development overlaps with his/her values"

[Bamberger (1983, p.26)]. Indeed, a study by Miller and Toulouse (1986), using empirical data from 97 small firms in Canada, found that, in some cases, the chief executive was the only firm member who was allowed to make strategic decisions.

Bamberger (1983, p.30) summarises results found by others who have studied the value systems, attitudes and objectives of entrepreneurs and managers, noting in particular that “objectives are strongly influenced by economic conditions; the firm’s life cycle phase and the industry it is in influence the pursued objectives and their relative importance; [and] in small and medium-sized firms, the objectives are formulated at the highest level of the firm’s hierarchy”.

The five stages through which a small, growing firm passes<sup>16</sup> are discussed by Churchill and Lewis (1983, p.32), who remark that, to begin with, “the owner *is* the business, performs all the important tasks, and is the major supplier of energy, direction, and, with relatives and friends, capital”.<sup>17</sup> They point out that the demands made by the business on such an owner-manager often become so great that he succumbs to the pressure and the business folds or dies.

It is not until stage III, ‘success’, suggest the authors, that the owner-manager delegates decision-making responsibility to subordinate managers. At this point in time, they argue, he has the choice between ‘disengagement’; whereby he increasingly moves away from the running of the business to assume a non-participatory role, allowing managers to make major decisions; or ‘growth’, which requires a greater ‘hands-on’ involvement on his part. Stage IV in the Churchill and Lewis analysis is ‘take-off’, which requires increased delegation of major responsibilities. At this stage, they note, “both *operational* and *strategic* planning

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<sup>16</sup> Existence, Survival, Success, Take-off, and Resource Maturity.

<sup>17</sup> See also Stanworth and Curran (1986) ‘Growth and the small firm’.

are being done and involve specific managers ... [although] ... the company is still dominated by the owner's presence" [Churchill and Lewis (1983, p.40)].

The final stage, 'resource maturity', is one in which a firm that retains its entrepreneurial spirit can flourish, so long as it also maintains its ability for "innovative decision making and the avoidance of risks" [Churchill and Lewis (1983, p.40)]. Among management factors, which Churchill and Lewis (1983, p.40) consider to be central to a small firm's success, are the "owner's goals for himself or herself and for the business ... [and the] ... owner's managerial ability and willingness to delegate responsibility and to manage the activities of others". The importance of these factors change as the firm grows. For example, "matching business and personal goals is crucial in the 'existence' [first] stage because the owner must recognize and be reconciled to the heavy financial and time-energy demands of the new business" [Churchill and Lewis (1983, p.42)]. According to this work, therefore, the aspirations of the owner-manager play an important part in decision-making within the small firm. He must be willing to be flexible and realistic about his ambitions and abilities when setting objectives for himself or his business.

The model of Churchill and Lewis does, however, have some drawbacks and, to an extent, the authors are guilty of their own criticism of others' frameworks for analysing businesses that "assume a company must grow and pass through all the stages of development" [Churchill and Lewis (1983, p.31)]. Assuming that the first stage for any new small business is mere existence, Stage I in their model, the rather sweeping statement that "systems and formal planning are minimal to non-existent" appears to be a rather rash underestimation of the potential of some new ventures, and it is without grounds [*cf.* Section 4.3: *Forward Planning* below]; as

is their additional comment that “the company’s strategy is simply to remain alive” [Churchill and Lewis (1983, p.32)] [*cf.* Section 4.3: *Aims, Ambitions and Making Decisions* below].

The main problem is that the authors assume that each stage must be passed through in chronological order. Overall, the model is unnecessarily complex, and does not suggest why each firm moves from one stage to the next concentrating, instead, on what considerations are relevant at each stage. As such, the model is merely taxonomic, rather than predictive and, although an interesting source of ideas, is not particularly helpful in an applied scientific sense.

An interpretation of strategic management is given in Shuman and Seeger (1986, p.11), who use the following definition of Smith *et al* (1985, p.4): “Strategic management is the process of examining both present and future environments, formulating the organization’s objectives, and making, implementing, and controlling decisions focused on achieving these objectives in the present and future environments”. They develop a model built on this definition and contrast it with the planning practice of 500 fast-growing private small companies in the United States. They point out that, in order to plan, a business must actually make “the decision to allocate some of its limited resources to planning ... [and that] ... while many employees should be involved in the preparation of the strategic plan, only the ... owner has the business perspective, the ability to orchestrate a company’s activities, the responsibility for setting objectives and the authority to review and change them” [Shuman and Seeger (1986, p.12)].

They echo earlier work [*cf.* Bamberger (1983), Churchill and Lewis (1983)] in noting that the owner-manager’s personal objectives are very much linked to company objectives. Such is the complexity of the interlinked goals and objectives

that the owner-manager should, they argue, “develop a careful list of specific objectives that are related to identified important personal needs” [Shuman and Seeger (1986, p.12)]. As far as company objectives are concerned, Shuman and Seeger believe that they should be separated from personal objectives, and defined under three distinct headings: sales volume, financial performance, and physical resources.

Results from their study show that owner-managers are likely to be involved at every level of decision-making, although the setting of company objectives is where they become most involved. The majority also appeared to “prefer an active and strong personal involvement in their company’s planning process, rather than delegating that responsibility to other members of the management team” [Shuman and Seeger (1986, p.14)]. The general finding is that, as the firm grows and becomes more complex, so planning is more likely to become formalised.

Shuman and Seeger offer two alternative explanations as to why planning is more complex in rapidly growing firms: either growth necessitates the adoption of formal strategic planning; or, it allows the firms in question to acquire sufficient resources (human and financial) to devote to planning. However, a major drawback, of which they show at least some awareness, is that simple cross-site analysis over one time period does not allow a clear distinction to be made between these two alternatives. Instead, what is required is a longitudinal analysis of firms to establish the reasons for changes as they occur. In addition, to distinguish successful strategies from those which are unsuccessful, we require a control group of slow growth firms for comparison with those experiencing faster growth.

David (1989, p.90) discusses the importance of a firm's "Mission Statement", defined as "an enduring statement of purpose that distinguishes one organization from other similar enterprises" or, put more simply, "a declaration of an organization's 'reason for being'" [David (1989, p.90)]. When contemplating formal, strategic planning, he adds, "a carefully prepared mission statement is widely recognized by managers and academics as the first step" in the process. His study examines mission statements gathered from large firms, and provides guidelines which he hopes to be of use to future strategy planners. It is also of interest to owner-managers of smaller firms, who are very close to their business, the mission of which may be linked to personal objectives. As David (1989, p.95) concludes, the importance of a mission statement is that it is "essentially a vehicle for communicating with important internal and external stakeholders, and its principle role is to clarify the ultimate aims of the firm". It would have been both useful and interesting to learn explicitly how firms integrate their mission statement into their strategic planning processes, but unfortunately David undertakes no exploration of this important avenue of research.

Strategic planning in small firms aiming for increased profit is a matter considered by Aram and Cowen (1990). Although, they agree, "many owner-managers realize growth and increased profitability depend ... upon enhancing second level manager's experience", because "high personal stakes are associated with the firm's future for the owner-manager, this individual often feels compelled to direct and control planning" [Aram and Cowen (1990, p.64)]. They discuss what they call "the 5 per cent difference": the small changes or increases in planning effort that can make a large impact on performance. A four stage model is presented which attempts to explain how to capture this 5 per cent difference.

First, they suggest that “planning meetings should be centered on goals”, which provides, among other things, a focus for discussion, the development of mutual incentives and the communication of clear expectations [Aram and Cowen (1990, p.66)]. Second, owner-managers should aim to explore specific issues or situations, forming, through discussion, new solutions and opinions. Third, management should work together as a team, seeking solutions to problems. And the fourth and final stage in this process is ‘action planning’, which is essentially the allocation of specific tasks to individuals, giving them responsibility for changes in planning. The benefits of following this planning process, argue Aram and Cowen (1990, p.69), are that it can “enhance a firm’s level of entrepreneurship ... [and] ... provide a source of organizational and managerial renewal by inspiring and energizing managers to seek new solutions to old problems or create new opportunities where none appeared before”.

The authors place much emphasis on what *should* be done, but with little reference to actual business practice. For example, they state that “effort focused on effective planning can obtain step function improvements in firm performance” [Aram and Cowen (1990, p.64)], but fail to back up this statement with empirical evidence. Of those examples that are given, the turnover of the firms concerned is \$20m to \$30m, certainly much bigger than those we commonly class as ‘small’ firms. The paper is largely theoretical and validates its assumptions about small firms with evidence from only four rather large businesses. A more sensible approach would perhaps have been to examine actual practice amongst small firms, and then to develop conclusions better grounded on empirical evidence.

Mintzberg (1991, p.612) identifies two advantages enjoyed by organisations in which decision-making lies with one single leader. First, there is the ability to

respond quickly to changes in the environment, as “only one person need act”. Second, the sense of “mission” felt in a business run by a strongly charismatic personality can lead to a feeling amongst firm employees of belonging to an enterprise that knows where it is heading and has the drive and determination to realise its goals successfully.

Allen (1993, p.16) talks of “Faith, Hope and ... expectations” in financial forecasting, and relates these to three different levels of control within organisations. First, the operational level, which is about “converting expectations into results”. Level two, the tactical level, is about “converting hope into expectations”. Third, the strategic level, is about “converting faith into hope”. He argues that “financial managers who are proactively involved at the strategic level of management are well aware of the task they have in distilling judgements into a quantified assessment”, but that the reluctance of many companies to seek outside advice has been seen to act as a “brake” on progress. In other words, he believes that companies that are willing to share their problems with others, and to seek outside advice on strategic planning, often benefit from the knowledge an unbiased observer can give.

The prediction of new firms’ performance is considered by Cooper (1993, p.241) to be a “challenge”, largely because of the “heavy dependence of new ventures upon environmental development”, but also because “many entrepreneurs pursue personal goals, some of which are noneconomic in nature”. His preliminary analysis of data, compiled for almost 3,000 young firms over three years, suggests that “whether or not they stay in business and their patterns of development may depend greatly upon the goals of the founder” [Cooper (1993, p.248)]. As the firm begins to grow, however, so more people become involved in the decision-



making process, authority is delegated and the goals of the business begin to change. Cooper spends most of the article discussing others' works and pointing out the drawbacks and difficulties of their approaches. What would have been more interesting, however, would have been to see how he applied the information available from his substantial database to addressing the problems he has uncovered.

Discussed later<sup>18</sup> are the transitional phases identified by Mount *et al* (1993), which see decision-making becoming more devolved and systematic as the firm passes from one growth stage to the next. On a slightly different note, Peiser and Wooten (1983) examine the changes experienced by small *family* businesses as they begin to expand. They argue that family-run businesses may encounter more problems than other small businesses because "normal growth problems are compounded by the difficulties of separating family relationships from business decisions" [Peiser and Wooten (1983, p.58)].

The "life-cycle crisis"<sup>19</sup> experienced by growing firms is said (p.60) to be exacerbated when "goals of the founding generation collide". Conflicting aims between members of the firm can lead to high tension and prolonged arguments, and can divert attention from the aim of the business itself. It can cause those involved to "lose sight of the strategic issues and to focus instead on daily minutia and the irritating work habits of the others" [Peiser and Wooten (1983, p.61)]. To avoid any such unnecessary and time-consuming conflict, Peiser and Wooten (1983, p.60) believe that "family members must share the same general goals of the

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<sup>18</sup> See *Forward Planning* below.

<sup>19</sup> Said by Peiser and Wooten (1983, p.59) to often occur "at the time when the second generation has developed enough expertise to assume major responsibility in the general management of the firm but the first generation is not prepared to share that responsibility".

firm” and, at the same time, “if authority is shared, they must agree on how the firm should best proceed towards these goals”.

One method of resolving crises within a family business, suggest Peiser and Wooten, and a method which can also be applied to other small firms, would be to employ an outsider to mediate; someone who is detached from the business and can take an objective standpoint.<sup>20</sup> A consultant, for example, could collate the views of all concerned, feed these back to members of the organisation and, using the information thus gathered, help to develop a strategic plan for the business to follow into the future. Indeed, they argue, such “outside intervention is strongly recommended” [Peiser and Wooten (1983, p.63)]. It forces individuals to verbalise their thoughts and ideas, and to communicate to others any problems as they perceive them and is, according to Hofer and Sandberg<sup>21</sup>, one of the key behavioural factors leading to a new venture’s success.

Peiser and Wooten adopt the model of Churchill and Lewis that describes growth stages of firms, and compare this to the life-cycle changes of the firms’ owner-managers. They too seem happy to accept that small firms and their owners automatically go through all of these stages. Although the concentration is on family based businesses, there is little in this paper to suggest that the problems they encounter are necessarily any different to those experienced by any small firm. For example, goal conflict can arise equally between two brothers, or two partners or multiple directors from different families and generations. Explicit empirical

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<sup>20</sup> See also Johnson and Devins (1994, p.13) who investigate the need for, use and sources of advice used by new and established small to medium-sized enterprises. Their findings suggest that “younger businesses are slightly more likely than older to pursue an internal solution”, but also that those who do not seek outside advice “do not appear to view cost as a major barrier”.

<sup>21</sup> See Hofer and Sandberg (1987, p.372), who claim that “successful entrepreneurs *seek outside help* to supplement their skills, knowledge, and abilities”.

evidence would be required to compare and contrast the differences between family businesses and other small firms, an area in which this paper falls short.

Obviously, it is beneficial to any new venture to be aware of others' experience in the market place, in order to best avoid making mistakes similar to any they may have made in the past. As Hay *et al* (1993, p.39) remark, "when starting out in a new venture, it pays to learn from others who have gone before". Their results find that "careful analysis of ... product market characteristics prior to start-up significantly increases the chances of survival and success" [Hay *et al* (1993, p.31)]. Knowledge of one's existing rivals and of customer demand and requirements must also therefore be of importance if the small firm is to keep its customers, attract new buyers from competitors and retain, or improve upon, its position in the market place.

A study of over 2,500 small firms by researchers at Aston Business School revealed that "only 22% were seeking fast growth, a further 57% slow but steady growth and 22% were not seeking to grow at all" [Lee (1994, p.4)]. If an owner-managed business is providing a comfortable living for the entrepreneur, who still has total control over the business, then the pursuit of growth might not be a major issue. The development of such a business must clearly be tied with the aspirations of the owner-manager, and with his values and personal qualities. As Bhidé (1994, p.153) asks, "is the entrepreneur's goal to build a large, enduring enterprise, carve out a niche, or merely turn a quick profit?" The answer to this question, which identifies goals of the owner-manager, should in turn identify the strategic direction the business will pursue.

Wheelen and Hunger (1995, p.368) agree that "personal and family needs may strongly affect the small company's mission and objectives and override other

considerations” and suggest three factors that might lead an owner-manager to chose stability over growth strategies: “(a) the owner is interested mainly in generating employment for family members; (b) providing the family a decent living, and (c) being the boss of a firm small enough to manage alone comfortably”. For a full and complete understanding of the goals of a small business, it is therefore important, they say, to be aware of the motivations of the owner-manager who controls the organisation.

Under the heading of *Aims, Ambitions and Making Decisions*, various articles from the small business literature have been discussed. It is thought that owner-managers tend to be very much involved in decision-making, especially in the early stages of a firm’s life-cycle, and that successful small business managers are those who are willing to seek an accept advice, and delegate responsibility as the business grows.

### *Forward Planning*

The production of a formal written business plan has become a necessity for new small firms trying to acquire seed-corn funding and start-up support. For example, the *National Westminster Bank* (1992, p.18) recommends the use of a business plan: “You need a Business Plan. Trying to run your business without one is like floating aimlessly at sea in a fog. You will now know where you are going, any more than where you have been or where you are. What is worse, sooner or later you will hit something”. They provide a *pro forma* plan as an appendix to the book, which requests information on: the business in general; key staff and their qualifications; the product or service and its suggested place in the market; available business premises, plant and machinery; and financial funds and needs.

Furthermore, there are forms for compiling an operating budget and cash flow forecast. This information, together presented in a neat and logical manner, will instil confidence, it is suggested, in organisations with the capacity to provide support to a new small firm: “Professional investors usually ask for a written business plan because it provides clues about the entrepreneur’s seriousness of purpose, concern for investors, and competence. So entrepreneurs must write a detailed plan even if they are skeptical about its relationship to the subsequent outcomes” [Bhide (1994, p.158)].

However, an article by Welsh and White (1981) examines the differences in organisation required by a small firm, as compared to a large one, and finds that forecasting, in particular, is said to be very difficult in smaller organisations because the business is likely to have little or no past experience or data on which to base predictions. Constraints on financial and time resources are also likely to prove restrictive, as the authors explain: “Because owner-managers of small businesses have few, if any, staff people to prepare plans and analyses, decisions to launch new projects are typically based more on hunch, necessity or desire, than on cold and extensive analysis” [Welsh and White (1981, p.28)].

Churchill and Lewis (1983) agree that planning in small firms is, in the early stages, minimal. By the ‘survival’ stage (II) in their five-stage analysis, “formal planning is, at best, cash forecasting” [Churchill and Lewis (1983, p.34)]. The formal process of strategic planning only occurs once the firm reaches stage IV, ‘take-off’, and is carried out by managers specifically appointed for the task. By the final, ‘resource maturity’ stage, planning is formal and detailed. They believe that a key factor of a successful small firm lies with the “owner’s strategic abilities for looking beyond the present and matching the strengths and weaknesses of the

company with his or her goals” [Churchill and Lewis (1983, p.42)]. The ability to do this will enable the owner-manager to prepare for change and ready his organisation to meet future challenges.

The question as to whether a small business *should* or *should not* make formal plans is addressed by Thurston (1983), who observes that plans can be either informal and unwritten, or formal and written, and that each may be appropriate, depending on the organisation concerned. He describes various business scenarios and the method of planning used by the businesses involved, and finds that “the presence or absence of formal planning appears not to be *the* major variable” [Thurston (1983, p.163)].

Thurston suggests, rather, that the success of a new small business and the level and form of planning required will depend upon a number of interacting factors, which may include: the administrative style and ability of the chief executive or owner-manager; the abilities of the managers who will implement new strategies; the complexity of the business; the strength of competition; the perceived potential gain from strategic planning; whether or not formal planning is, or can be, a substitute for the owner-manager’s own leadership role; the level of uncertainty faced by the company; and the understanding and effective implementation of formal planning.

In order to plan for the future, says Thurston (1983, p.168), the owner-manager must first “gain an understanding of [his] business as it has been and as it is now” by getting to “the heart of what the company’s strengths and weaknesses are - what customers buy the product or service and why”. This, he adds, should also be an on-going part of each manager’s job. Having understood the business, the next step is then to set objectives, and finally to “generate, weigh, and choose

among alternatives” [Thurston (1983, p.176)], before starting on a business plan. Thurston (1983, p.184) argues in favour of firms laying down a plan, and suggests that owner-managers “search out ... the appropriate level and structure of formal planning for [their] company’s particular situation”, adding his belief that, in future years, “the planner will increasingly have the edge”.

What Thurston fails to note is that, for many small businesses, the only way to attract any funding support is through the preparation of a formal, written business plan. This is standard practice amongst UK clearing banks. There are some possible explanations for this omission; for example, the paper was written in 1983, and feelings towards business plans have changed substantially since then; further, practice in the USA might be very different to that in the UK and, particularly, Scotland. Probably more important, though, than merely knowing how to write a plan, which may simply be filed or thrown away after appropriate support has been achieved, is learning the methods by which the plan may be integrated into the strategic management of the business. This is a point upon which Thurston only touches, in his section on ‘Implementation and Feedback’, and which could be usefully expanded upon by including some reference to case study evidence.

A useful summary of small business planning research is given in Robinson and Pearce (1984), who provide a bibliographical analysis of works dating back to the 1950s. They find that, even as recently as the 1980s, there has been a very limited amount of empirical research into small firm planning. The conclusions they draw from what work *has* been done are that first, it has been “sufficiently documented that most firms do not formally plan” [Robinson and Pearce (1984, p.135)]. Second, they remark upon the existence of “several studies that support a favourable perceived or objectively measurable impact of strategic planning on

small firm performance” [Robinson and Pearce (1984, p.135)]. Third, they explain that “the planning process within small firms deserves considerable attention” and propose areas in which research on this topic might be pursued<sup>22</sup> [Robinson and Pearce (1984, p.136)].

Actual planning practice in smaller rapid growth firms is the subject under analysis by Shuman and Seeger (1986, p.14), who group their findings under four main headings. The first, ‘Management’s Planning Posture’, is concerned with the attitude of owner-managers to planning. Although time is a major constraint on strategic planning, they still find that most people running a small business “feel that improved time efficiency, company growth and a better understanding of the market will be achieved through planning”. They also find that those with previous experience of planning and who had prepared a business plan before start-up “were likely to go through the major elements of the planning process once their companies were operating”.

The second category they call the ‘Planning Process’, and this looks at the types and methods of planning in actual use. They find [Shuman and Seeger (1986, p.14)] that, “while one-half of the companies did not have a ‘formal’ business plan at start-up, the majority adopted some form of strategic planning once the company was in operation”, and that growth, in terms of sales, leads to a more formal and structured planning process. However, the strategic planning in the firms in the sample is typically “primarily concerned with the short-run, updated regularly, and operationally oriented”, rather than based on long-term forecasts and

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<sup>22</sup> The authors suggest, for example [Robinson and Pearce (1984, p.136)], an investigation into the meaning of ‘informal’ as opposed to formal planning; the use of ‘outsiders’ in the planning process; and a study of what specific activities would comprise the planning process.



budgets.

The 'Planning Areas' provide the third grouping, where it is found that around two-thirds of firms focus on planning with regard to marketing<sup>23</sup>, and one fifth on operations; only four per cent target planning in the financial area. And the final heading under which Shuman and Seeger choose to group their results is that of 'Planning Organization'. They find that owner-managers like to take an active role in planning, and that 15 per cent of companies have personnel employed specifically for planning purposes. Of those companies that anticipated going public at some point, the majority intend to increase the formal structure of their planning process before such an event takes place.

Kayser (1990) presents results from an empirical study carried out in Germany on business start-ups. The work analyses these firms' growth, in terms of turnover, employees, profitability and investment, over the first seven years of existence. A surprising result from the analysis of his results is that "planning does not [have] the influence on starters' ability to achieve a competitive advantage we had supposed" [Kayser (1990, p.237)]. In fact, he goes on to say that "the only positive result concerning the well planned start-up is that in these cases problems with competitors appear earlier than in the non or poorly planned new companies". Kayser (1990, p.237) concludes from these results that "the phase of consolidation and growth is the phase in which ... competitiveness as a result of innovativeness and knowledge of the market structures mainly determines the further development of young firms", rather than the existence of a formal planning process. Kayser

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<sup>23</sup> For further enlightenment on marketing in small firms see, for example, Carson (1985, p.15), who provides a model of "the evolution of marketing in the development of small firms"; or an article by Colleran (1985) who examines 'strategic marketing', and proposes a framework for developing this in a small business.

(1990, p.236) points to his finding that “planning and innovativeness of a start-up project must ... be regarded as a success and growth factor ... [although] it is not the guarantee for starting a successful and long living company”. However, he does not describe how either ‘planning’ or ‘innovativeness’ were measured for this sample of firms, which leaves the reader curious, and none-the-wiser for having read the paper.

Baker *et al* (1993, p.82) point out that structured planning had come under criticism in recent years because “form became more important than substance in many firms”. Their study reports upon the experience of high-growth US firms who have implemented formal procedures for strategic planning, and the methods by which this has been achieved. They find that “written business plans are used more for internal management purposes than for start-up funding” and also that “the completion of strategic planning is positively associated with a firm’s profitability” [Baker *et al* (1993, p.82)].

They further note that “for strategic planning to be most effective, many business consultants, business educators, and business people feel that the planning process should result in a formal *written* business plan that can be used for communicating with both external and internal audiences alike” [Baker *et al* (1993, p.83)]. The reasons that a formal written plan is considered to be better than an idea simply held in the mind of the entrepreneur are identified as follows: first, a formal plan aids “critical thinking and group decision making”; second, it facilitates “internal and external communications”; and third, it can act as a “control mechanism for course correction” [Baker *et al* (1993, p.83)].

Prompted by these thoughts, the purpose of the study by Baker *et al* is to establish whether fast-growth firms develop written business plans and, if so, how

they do this and what benefits are consequently conferred upon the firm. The results show that the majority of plans were used to aid internal management, by such means as guiding company operations, measuring performance and establishing incentives for managers. Interestingly, it was found that less than half of the firms considered in the study used a written business plan to help obtain funding.

Through a breakdown analysis of most profitable versus least profitable firms in the sample, Baker *et al* (1993, p.85) establish that there was “no significant difference between the profitability of the firms that *did* and *did not* prepare business plans in each of the two categories”. Strategic planning appeared to be a more important predictor of profitability, with 100 per cent of the most profitable firms taking part in some sort of formal planning, compared with 72.9 per cent of the least profitable firms. Based on their findings, Baker *et al* (1993, pp.87-88) suggest a four-phase approach to implementing strategic planning: first, a one to three year strategic plan should be developed to indicate the firm’s mission using an analysis of strengths, weaknesses, opportunities and threats; second, the business plan should be prepared with full documentation for management and employees; third, the plan should be communicated and implemented, with employees and managers establishing their own goals consistent with company-wide plans; and fourth, there should be a regular (at least quarterly) formal review of actual performance compared to that planned for. Adhering to the stages of this approach, claim Baker *et al* (1993, p.88), will “help produce increases in organizational effectiveness”.

Throughout the paper, Baker *et al* relate strategic planning to its effects on profitability, assuming that this is the main indicator of success in a small firm.

However, it is common knowledge that many small firms, especially young small firms, will often make losses, or just break even, whilst still considering their business to be successful according to criteria set by the owner-managers.<sup>24</sup> Particularly in the early years, it is often more important to them to invest in plant and equipment, building a solid basic infrastructure, before seeking higher profit margins. For Baker *et al* to use merely profit as an indicator of success, and then to claim that following the strategic planning processes adopted by firms with higher profits will lead to increased organisation efficiency, is perhaps both an unwise and unsubstantiated claim.

In addition to providing a clear brief of the aims of the business to potential investors and organisations geared towards supporting new enterprises<sup>25</sup>, the business plan may also serve as a useful checklist to the owner manager himself. As the business proceeds, so he is able to monitor budgeted against actual performance, and to take corrective action as and when this proves necessary. Johnson and Devins (1994, p.6) found “evidence to suggest that a substantial proportion of SMEs [Small to Medium sized Enterprises] are involved in the production of a formal written business plan which is regularly reviewed”. Their work is based on a sample of SMEs in the Leeds area, and results show that 43 per cent of the SMEs under investigation had a formal written business plan. Bhidé (1994) reports different statistics from an analysis of fast-growing US companies. Only 28 per cent in the sample had a fully written-up business plan, with 41 per cent having no plan at all. One reason for this, it is suggested, is that, because of the entrepreneurial nature of these new firms, “an ability to roll with the punches is

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<sup>24</sup> For example, taking a share of their rivals’ customers.

<sup>25</sup> Such as the local Enterprise Trusts and Development Companies.

much more important than careful planning” [Bhide (1994, p.152)] [*cf.* Mintzberg (1979, 1994)].

Fass and Scothorne (1990) report on the purposes for which Training and Enterprise Councils (TECs) and the Scottish equivalent, Local Enterprise Companies (LECs), were originally set up. They aimed to “improve the sensitivity of [public] resources to local need and to create a clearer and more coherent service for its users by bringing together training and enterprise” [Fass and Scothorne (1990, p.1)].<sup>26</sup> The success of these TECs and LECs, they continue, had to depend upon their clear understanding of *who* their clients were to be, as well as the goals they were to help their clients achieve. The economic development task undertaken by TECs and LECs could be, claim Fass and Scothorne (1990, p.7), “justified by wealth creation”, but is, they add, “driven by the motivation of individuals who are all seeking their own personal goals”. For enterprise organisations, a business plan produced by or with the help of the entrepreneur will help to clarify the aims and objectives of the business “in such a way as to test the viability of converting the idea [of the entrepreneur] into a commercially viable reality” [Bull (1993, p.28)].

The transitional stages through which a small, growing firms passes are the focus of the work by Mount *et al* (1993). They identify five main phases, as follows: (1) the owner-operated organization; (2) transition to an owner-managed organization; (3) the owner-managed organization; (4) transition to emergent functional management; (5) emergent functional management. As the growing business

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<sup>26</sup> See also Curran and Downing (1983, p.143), who find that “actual take-up of government assistance was relatively low, [primarily because of] the passive stance of departments offering help, ... the bureaucratic aspects, ... and the time taken to receive a decision”.

reaches each new phase, the role of the entrepreneur changes. At first, “personal experience plays a key role in operating decisions” and there is “little systematic consideration of marketing, production, personnel, finance and accounting as separate functions” [Mount *et al* (1993, p.114)]. Gradually, however, there comes a “more deliberate approach to decision-making, and a tendency toward shared authority” until finally there exists a “management team comprised of experts in some functional areas, who share in the decision-making” [Mount *et al* (1993, p.116)].

Mount *et al* (1993, p.118) believe that the owner-manager needs both a “longer term focus and the ability to manage change” if the organisation is to reach the next phase in the line of development. Planning is seen to be particularly important during the transitional phases, when the organisation is in its most vulnerable state, and it is during these times that there is a “clear need for direction and objectives”. They admit that the demands put upon the owner-manager of a new business can be so time-consuming that he is unable to devote a great deal of attention to any type of planning, but still suggest that “strategic planning can have a positive impact on the effectiveness of organizations across the phases of development” [Mount *et al* (1993, p.119)].

Mount *et al* follow similar lines of research to others [*cf.* Churchill and Lewis (1983)] who seem to think small firms can be classified very neatly into various stages or phases in their development. What they do not seem to acknowledge, however, is that transition from one stage to the next is often a slow and gradual process, and that the edges of these phases can become very blurred. Indeed, most firms probably could not pinpoint the time at which they moved from one stage to the next, so suggesting courses of action to be followed in each phase would be

unhelpful to them. It would have been more interesting to read a discussion of what the authors call “the factors which influence success and failure in each phase” [Mount *et al* (1993, p.120)], rather than simply to be given a description of the structure of the typical firm at each phase of its development.

Bhide (1994, p.150) on the other hand is quick to point out that a “comprehensive analytical approach to planning doesn’t suit most start-ups” and that “analysis can delay entry [e.g. into a new niche] until it’s too late or kill ideas by identifying numerous problems”. He does concede that at least a little analysis and planning can be worthwhile, and suggests [Bhide (1994, p.150)] the following entrepreneurial approaches be adopted: “(1) screen opportunities quickly to weed out unpromising ventures; (2) analyze ideas parsimoniously. Focus on a few important issues; (3) integrate action and analysis. Don’t wait for all the answers, and be ready to change course”. Bhide (1994, p.161) concludes with the recommendation that “entrepreneurs should play with and explore ideas, letting their strategies evolve through a seamless process of guesswork, analysis and action”, which seems to suggest that some planning, although not formally defined as such, is a necessary requirement for new small firms.

The usefulness of having a business plan, suggest Wheelen and Hunger (1995, p.367) is that it “serves as a vehicle through which financial support is obtained from potential investors and creditors” and, they claim further, “starting a business without a business plan is the quickest way to kill a new venture”. They provide a suggested table of contents for the strategic business plan of a new entrepreneurial venture<sup>27</sup> and recommend that “the proposed venture’s mission, objectives,

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<sup>27</sup> See Wheelen and Hunger (1995, p.368).

strategies, policies, likely board of directors (if a corporation), and key managers” be developed, along with the specification of internal factors and generation of performance projections [Wheelen and Hunger (1995, p.366)]. They conclude that small businesses that use formal plans tend to perform better than those that do not, and point out that “the process of strategic planning, not the plan itself, appears to be a key component of business performance” [Wheelen and Hunger (1995, p.380)].

### *Funding Growth*

One of the major problems facing a new small firm is that of financing its operations or its growth. Welsh and White (1981, p.18) discuss this problem and the differences between the financial structures of large firms vis-à-vis those of small firms. There are several major points to be drawn from their work. First, they argue that “the very size of small businesses creates a special condition ... that distinguishes them from their larger counterparts and requires some very different management approaches”. They term this phenomenon ‘resource poverty’, and explain that it results because of the highly fragmented industries in which small firms tend to operate. Second, the salary of the owner-manager commands a much greater proportion of revenues than is the case in a larger firm. And third, “external forces<sup>28</sup> tend to have more impact on small businesses than on larger businesses”.

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<sup>28</sup> For example, changes in government regulations, tax laws, labour and interest rates.



The authors contend that a small firm is “seldom in equilibrium<sup>29</sup>, or even near it” [Welsh and White (1981, p.24)]. In other words, they add, it may be “subject to very significant short-term fluctuations compared with the overall cash flow”. They suggest that ‘breakeven analysis’<sup>30</sup> is a suitable, and widely used method for “determining the sales needed to support a new business, a new product, a new sales outlet, or a new plant” [Welsh and White (1981, p.26)]. The concept is a simple one, and may be communicated in a visual manner by plots on a graph. A drawback of this method, however, is that its accuracy “depends on detailed and conservative planning” [Welsh and White (1981, p.28)]. Still, owner-managers might find it useful to visualise future operations in the detail permitted by breakeven analysis, and can, as the authors explain, “portray operations, ... [for example, in terms of an income statement], changing the numbers to reflect a variety of contingencies and deciding how to handle these various situations in advance”. Accountants can do this on a simple spreadsheet, and the resulting output provides a ‘variance analysis’, which shows the change in income or outgoings for a given change in, for example, production.

An interesting observation of Welsh and White (1981, p.29) is that “a small business can survive a surprisingly long time without a profit [but that] it fails on the day it can’t meet a critical payment”. This implies that cash flow is more important in a small firm than profit or return on investment, at least in the short-term. Jarvis *et al* (1996, p.32) confirm this with “substantial evidence ... that the management of cash flow was important” in an in-depth study of 20 small UK

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<sup>29</sup> Welsh and White (1981, p.22) note that, “in big businesses the rates of exchange and annual growth are normally small; thus their financial statements describe a system in approximate equilibrium”. This is not the case for a small firm, where even small changes can lead to a relatively major upheaval.

<sup>30</sup> The ‘breakeven point’ being that at which revenue is equal to costs.

firms. To lenders of money, though, a critical factor to be considered, before contemplating a loan, is the magnitude of the firm's 'debt-equity' or 'gearing' ratio. Welsh and White (1981, p.30) argue that "blind application of the debt-equity ratio criteria ... can, and often does, threaten ... survival", as "a small business that survives start-up losses may have excellent capacity to service an additional debt burden".<sup>31</sup> Losses on its balance sheet, though, which are only too common in a new, small firm, will count against it, raising the gearing ratio to a level above that at which a lender will even consider giving a loan.<sup>32</sup>

Churchill and Lewis (1983) believe that financing becomes most important at the 'success' stage (III) in their analysis of small firm growth. In the earlier stages, finance usually comes from the owner-manager, friends and/or relatives<sup>33</sup>, but by stage III, the owner-manager can either choose to 'disengage' himself from the business, or to 'grow'. Should he take the latter option, they say, then "the owner takes the cash and the established borrowing power of the company and risks it all in financing growth" [Churchill and Lewis (1983, p.34)]. A key concern at this point is to maintain profitability, and to train managers "to meet the needs of the growing business ... [and who have] an eye to the company's future rather than its current condition" [Churchill and Lewis (1983, p.34)].

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<sup>31</sup> See Levin and Travis (1987), who support the reasoning that one should be wary of using standard financial indicators, such as the gearing ratio, to measure the performance of a small business, and provide several reasons why they believe this may be prudent: for example, the line between debt and equity is blurred; lifestyle is a part of financial statements, and personal assets may appear in the balance sheet; standard financial formulae do not always apply; personal preference determines financial policies; and banks often combine personal and business wealth.

<sup>32</sup> Welsh and White (1981, p.31) quote the example of a small firm that was turning over \$1 million per year, had a net worth of \$5,000, and required \$300,000 debt finance. The gearing ratio was calculated at 60 ( $300,000 \div 5,000$ ) and the bank, therefore, refused the loan. They based their decision on the fact that a ratio of 2 or less, say the authors, is common in most successful big businesses.

<sup>33</sup> This assumption seems to conflict with the work of Kayser (1990, p.233), who finds empirical evidence that "young firms have no time to stop to take breath ... [and] big investments have to be made already after their first and second year of existence".

A major concern of the authors' stage IV, 'take-off', is the financing of rapid growth. They pose the question: "Will there be enough [cash] to satisfy the great demands growth brings ... and a cash flow that is not eroded by inadequate expense and controls or ill-advised investments brought about by owner impatience?" [Churchill and Lewis (1983, p.40)]. The owner-manager, they suggest, might need to be willing to take the risk of having a high debt-equity ratio, always assuming he can command the required resources, if the business is to continue along the projected path.

In order to pursue strategies for growth, an owner-manager must be willing to be flexible in his attitude to funding. He may need to be willing to forego a percentage of current profits or to dilute his equity holding, for example by taking on a partner who will inject capital, if this will lead to greater turnover in the long run [*cf.* Storey (1994)]. He should evaluate carefully the various methods open to him of utilising profit. Bull (1993) explains that a company basically has a choice between two options: they can either distribute or reinvest profit. The owner-manager should attempt to weigh up the advantages of both decisions, choosing the one that he believes best serves the aims of the business. "Management needs to recognise the relative importance of ... different forms of return<sup>34</sup> ... in targeting the kind of investor that best satisfies the company's requirement for growth" [Bull (1993, p.29)]. Bhidé (1994, p.154) agrees that "the entrepreneur must be able to secure others' resources on favourable terms and make do with less".

Entrepreneurs should be wary of depending too much upon customers paying for large orders on time, as "an unexpected need for cash ... may shut down a venture"

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<sup>34</sup> Which, suggests Bull (1993, p.29) could be, for example, "dividend payments or capital growth through reinvestment".

[Bhide (1993, p.156)]. They should therefore, according to Bhide (1993, p.156) “favor ventures that aren’t capital intensive and have the profit margins to sustain rapid growth with internally generated funds”.

Harris (1993) investigates various options for raising finance, considering both factoring and invoice discounting.<sup>35</sup> From an interview with the chairman of the Association of British Factors and Discounters he discovers that “when businesses want to expand - which is what is increasingly happening now as growth starts again - they turn to factoring to help produce the investment cash they need” [Harris (1993, p.40)]. The main reason for companies using factoring, claims Harris, is to improve upon or help solve problems with their cash flow. In addition, though, they gain other unexpected benefits, according to survey evidence<sup>36</sup>, such as “confidence derived from financial advice, improved financial disciplines for the company and reduced stress among managing directors and managers” [Harris (1993, p.41)]. However, Harris is writing from the perspective of those working in the factoring industry, who are effectively selling their service and therefore flagging its advantages. Little empirical evidence exists to suggest exactly how small firm owner-managers themselves feel about such possibilities, so the benefits identified by the Association of British Factors and Discounters may not, in practice, be as much in evidence as they declare.

Hawkins (1993, p.58) agrees that factors are “good at ... helping small to medium-sized businesses to expand and develop”, but points out that factoring and discounting “work best when the client company has a product or service which is

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<sup>35</sup> Invoices are bought over from a company, which is paid instantly in cash a sum commonly representing up to 80% of the value of its invoices. The company receives the outstanding balance when the debt is met.

<sup>36</sup> From AIM Market Research.

capable of strong growth and where, by intelligent use within the business of additional funding, management can obtain optimum benefit from the 'gearing' effect that advance payments against debtors can bring about". He suggests that managers consider the benefits of taking on a full factoring service against the additional cost of such a service, for example, savings in management time and quicker payment of debts, and concludes that a good relationship with the company's factor can "provide really critical support to a business during its formative years" [Hawkins (1993, p.59)]. What both Harris and Hawkins seem to neglect is that a young small business that is experiencing a cash flow crisis might find the charges levied by factoring organisations particularly burdensome during its early life-cycle. Whereas they operate on the premise of being a helpful means of improving cash flow management, in reality they may constitute a debilitating drain on young firms in their eagerness to profit from businesses in straightened circumstances.

A paper by Reid (1996a) reports on empirical evidence of funding shortages experienced by mature micro-firms in Scotland.<sup>37</sup> The data were collected by telephone interviews and his analysis shows that a "variation of part-time employees provided the most powerful leverage on the probability of experiencing a funding shortage" [Reid (1996a, p.35)]. A key finding is that "a ten per cent increase in part-time employees ... lowers the probability of experiencing funding shortages by two and a half per cent". Reid (1996a, p.36) also finds that firms with a high turnover are more likely to experience shortages in funding than those with a low turnover, and that "owner-managers of small firms that had experienced

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<sup>37</sup> See also Binks and Ennew (1996), who investigate the problems faced by small firms in trying to gain credit.

funding shortages tended to think that their plights could be improved by more financial support from friends and family, and by a more permissive bank lending policy, but that they would only be worsened by an extension of trade credit". These results suggest that micro-firms might be unwilling to take on board the facilities offered by factors and discounters, outlined above, if other methods of financing were available.

### *Information, Technology and Communications*

In Porter and Millar (1991) the authors describe how information can give a firm competitive advantage. Technology is improving the speed and reliability with which information is passed around the globe. As they point out, "dramatic reductions in the cost of obtaining, processing and transmitting information are changing the way we do business" [Porter and Millar (1991, p.33)]. Their work aims to help firms adapt and respond to the overwhelming threats and opportunities that are opened up by major breakthroughs in technological innovation.

As has been mentioned previously, technology is affecting Porter's *value chain* at all stages [*cf.* Section 2.2: Corporate Strategy], both at the primary activities and support activities level. The coordination of all of the activities that constitute a successful business requires *linkages* between these activities, and also to external bodies of, for example, suppliers and buyers: "A company can create competitive advantage by optimizing or coordinating these links to the outside" [Porter and Millar (1991, p.34)]. Information technology (IT) can assist a firm in so doing, enabling them to communicate with suppliers and buyers more effectively than before. Porter and Millar (1991, p.40) state that "in any company, information

technology has a powerful effect on competitive advantage in either cost or differentiation". It remains for firms to exploit these opportunities as best they can.

Cooper *et al* (1991) agree that technology can assist small firms that use these new technologies to differentiate their products or to attack new niches. Information technology is about transferring, storing and processing information. Electronic mailing systems and networks are growing at a rapid pace, and any small firm that is adaptable can take advantage of new opportunities on offer. As Cooper *et al* (1991, p.620) note, industries in which there is little or no technical change offer few opportunities for small firms to break into the market, but "changes in the form of deregulation, new technology, organizational and management innovations, and changing customer preferences create opportunities for new firms". Indeed, Storey (1994, p. 146) suggests that "it may also be the case that more technologically sophisticated businesses, even in conventional sectors, are likely to grow more rapidly than those with lower levels of technical sophistication".

Variyam and Kraybill (1993, p.136) remark that the small scale research and development carried out by small firms "may include a greater reliance [than that of larger firms] on the acquisition of technical knowledge and the adoption of new technologies from external sources such as trade publications, scientific journals, and government agencies". Given that, because of their small size, having a separate R&D department would be both unnecessarily costly and time-consuming, this would appear to be a reasonable assumption.<sup>38</sup> Their results also show that

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<sup>38</sup> See also Reid, Siler & Smith (1996, pp.41-2), who find evidence to suggest that "non patenting firms are benefitting from technological diffusion, ... occurring by free transfer of intellectual property within the larger net of firm relations that enmeshes the non-patenting firms".

the better educated the owner manager, the more likely is the firm to follow strategies such as planning and the implementation of new technologies to pursue growth.

The paper by Variyam and Kraybill is certainly interesting, but it has significant limitations. The authors present the results of four regressions, the dependent variables of which are defined as strategies; for example, one measures the importance of using new technologies to the firm's competitive strategy. The adoption or otherwise of these so-called 'strategies' is explored by a number of firm-specific variables such as size, age, sector and human capital. To define a strategy as being simply the respondent's perceived importance of a factor at one point in time is completely unconvincing if the researchers do not extend the analysis over a greater time horizon. Strategy is much more than a single event or issue, but is instead a process of interlinked procedures. However, to their credit, Variyam and Kraybill do at least acknowledge (1993, p.144) that "a model of firm growth in a dynamic framework ... would allow better control of self-selection effects and better modelling of the intertemporal aspects of strategy adoption and firm performance". Also, an ordered probit or logit would be a more appropriate statistical method than regression analysis, as the dependent variable is not a continuous real variable.

Dodgson and Rothwell (1989, p.145) provide evidence to show that "in some cases ... smaller firm strategies [for technology] are just as sophisticated as those in large firms, if not more so". They present data to show that new technology based firms and high-tech small to medium-sized firms (SMFs) have become increasingly important in recent years, and put this down partly to the opportunities provided by



information technology.<sup>39</sup> The SMFs analysed in the study were highly technologically advanced, often with strong technological links to external bodies such as universities, research institutes and other companies. These links were to prove important as many of the high-tech firms had products of very short life-cycles. Research and development were therefore a key part of what they did, when seeking to diversify, and links with other similarly-minded institutions were an important factor.

A study carried out in Sweden which investigates various tourism enterprises and organisations finds that “the networks and relations with which an enterprise establishes contacts seem to have a certain effect on whether or not it will be successful” [Steene (1991, p.667)]. The study also finds that enterprises whose employees are involved in other activities, such as politics or clubs, are also more likely to be successful than those who are not. Steene, however, chooses not to define success, and provides little evidence to convince the reader of his findings or conclusions in this narrative-style note.

Another study, by McNicoll (1994), compares social networking between prospective entrepreneurs in Scotland and Boston, Massachusetts, concentrating on entrepreneurs who are at the “pre-start-up” stage. The author suggests that “social networking is important in the firm formation process ... [and provides] a mechanism through which the would-be entrepreneur can access expertise and assistance which will assist him/her in taking forward his/her business idea” [McNicoll (1994, p.1)]. The sample of American respondents had many more (in

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<sup>39</sup> Other factors mentioned include: biotechnology, new materials technology and the developing software industry; the creation of new capital markets; growth of available venture capital; and an improvement in policies and attitudes directed towards entrepreneurs [*cf.* Dogson and Rothwell (1989, p.146)].

both number and frequency) social contacts than their Scottish counterparts, received better professional and business advice from within the family group, and were more willing to accept in a constructive manner criticism from friends. The author concludes that the American sample showed “a greater understanding and appreciation of the need to network” and suggests that “there is clear evidence that the more active networkers demonstrate more success at accessing the finance, advice and assistance which they need to help them develop their business idea” [McNicoll (1994, p.14)]. Compare this with Curran’s (1996, p.23) finding for UK firms that “speculative networking or highly proactive networking ... to further the aims of the business are relatively rare or, at best, a small proportion of total links maintained, [and that] while a small fraction of owner-managers or owner-managers in some sectors may act in these ways, most small business owners have neither the time nor the inclination to behave in such ways”.

The study by McNicoll (1994), and also, to a degree, that of Curran (1996), is essentially an observational and qualitative analysis of the behaviour of entrepreneurs, rather than a prescription for ‘best-practice’ as regards networking. McNicoll finds that networking is distinctly different between respondents from the Scottish and US samples, but falls short of suggesting why these differences are important. There may indeed exist a clear distinction between the two groups of entrepreneurs, but what McNicoll fails to take into account is that these may be due, in part, to social and macroeconomic differences between the two countries, rather than a failure on the part of the Scottish entrepreneurs.

To conclude this section, it is suggested that firms that are able to use new technologies should find that they begin to experience a competitive advantage over rivals who have failed to take on board and exploit the new systems IT has

made available. To learn from Drucker (1995, p.370), “Advances in scientific and nonscientific knowledge can create new products and new markets [and] advances in two different areas sometimes can be integrated to form the basis of a new product”. Firms that can integrate technology into their existing systems, both for information gathering and for communications, are fortunate to be in such a position. But those who fail to appreciate in time the importance of IT may find, in the future, that technology and customers are leaving them behind.

### *Quality Control and SWOT Analysis*

One of the tools that will enable management in small firms to plan more effectively is ‘situation analysis’ which, according to Shuman and Seeger (1986, p.12), will help it to “gain an understanding of its business as it has been and as it is now”. It is, they explain, a method of examining both the internal and external influences on the firm: “Internally, it defines strengths, weaknesses, and resources available or potentially acquirable. Externally, it defines competitive position, opportunities and threats in the present and anticipated environment” [Shuman and Seeger (1986, p.12)]. Selection of suitable strategies is thereby facilitated, as the firm can see more clearly how it can or should match up its resources with strengths and opportunities; while at the same time combating its threats and improving upon its weaknesses.

Techniques such as that above are aimed at improving the firm’s performance, by helping it to target effectively the correct niche for its product, and to take

advantage of its core capabilities.<sup>40</sup> Competitive advantage can also be brought about by the customers' perception of the firm's product quality: if they believe it to be better than that of its rivals, then they are more likely to switch between goods and purchase the new, or improved, product. As Ward and Stasch (1988, p.27) explain, "even if the product associated with a new strategy is not a new form of an already existing product, it can be a meaningfully different product to certain target markets if it is of higher quality than the competitor's products".

A recent development in management techniques is that of Total Quality Management (TQM).<sup>41</sup> The focus of such a system is on continuous improvement and the belief that quality is the responsibility of every employee: "When an organisation embraces TQM, it acquires a set of fundamental beliefs and values", one of which is "dissatisfaction with the *status quo* - always believing that something can be done better" [Hand (1993, p.58)]. Recent accounting literature stresses the importance of integrating strategic planning and quality systems, as Hand (1993, p.58) explains: "As organisations develop in quality maturity, the need to be able to integrate planning for quality with the strategic planning process becomes increasingly important". What Hand does not comment on, however, is the amount of time, effort and resources that need to be dedicated to implementing a TQM system. These may prove to be too much of a drain, especially in smaller firms, where each member of staff is usually working very hard already, and time

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<sup>40</sup> Bakker *et al* (1994, p.14) state that "focusing on a corporation's core competencies, understanding its strengths and weaknesses, is one of the first steps to strategically cultivating successful new business options". Their work is concerned with developing new business opportunities in existing, large corporations, but equally may be applied to the case of the new small firm trying to enter a market for the first time.

<sup>41</sup> Defined in CIMA's (1991) *Official Terminology* as "the continuous improvement in quality, productivity and effectiveness obtained by establishing management responsibility for processes as well as outputs".

and money are scarce resources.

Hankes (1993a, p.32) interviews two businessmen experienced in TQM techniques and discovers that “an underlying concept of TQM is that quality should be universally *owned* ... [and] is not a shopfloor problem but the concern and responsibility of every employee”. The respondents found that maintaining employee commitment and implementing TQM over a long time period was better than installing a completely new system in one go. They also warned against allowing consultants to “bully” management into taking unnecessary steps and, in effect, letting them take over the business, running it to their own plans and ideas.

A TQM plan will obviously involve some changes in the way the business is run, but it “should be integrated into the existing business planning process” [Hankes (1993a, p.32)]. Some of the ways in which this can be done are suggested, as follows: first, reports of actual results against quality targets should be reported along with the monthly accounts; second, an annual “quality plan” should be prepared, analysing past performance and setting future targets; third, note should be taken of “quality defects” or customer complaints, and appropriate remedial action taken.

Once the initial commitment to a quality system has been obtained from all employees, this should be maintained through incentives such as training programmes and continuous involvement. Communication is thus important for both morale building and making others aware of objectives. In a follow-up interview with the same two respondents, Hankes (1993b) discovers that SWOT analysis<sup>42</sup> is seen as a useful tool for measuring performance and highlighting areas

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<sup>42</sup> An analysis of Strengths, Weaknesses, Opportunities and Threats. See Section 2.2 above for further explanation.

for investigation. One firm found it advantageous to set out to achieve the environmental British Standard BS5750. Other initiatives were also seen to be important in communicating to those external to the organisation the firm's commitment to quality. Specifically mentioned were the government's "Investors in People" programme, "Return to Learn" and other training and youth employment schemes.

Partridge and Perren (1993) argue that strategic management can be assisted by using Porter's *value chain* to compare the current position of the firm with that expected from a selected strategy, in order to identify a strategic "gap". This gap can then be filled with the implementation of a plan using a combination of, for example, Activity-Based Costing (ABC)<sup>43</sup> and the value chain analysis. They claim that popular management techniques, including TQM and ABC, "can be integrated into Porter's framework at the implementation phase ... [and] should be seen as enabling techniques within the overall context of the strategic direction of the company" [Partridge and Perren (1993, p.38)].

An extension of TQM is discussed by Madu and Kuei (1993) who introduce what they call "Strategic Total Quality Management" (STQM). This, they say, is "driven by customers and environmental needs and looks to identify critical factors that determine the survivability and competitiveness of a firm in the near future" [Madu and Kuei (1993, p.121)]. It therefore concentrates not only on the quality of the products or services provided, but is also "a philosophy that considers socially responsible and environmental decisions and integrates them into total quality management in order to improve the global competitiveness of a firm by

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<sup>43</sup> For further discussion on ABC systems, their use and implementation see, for example, Glad (1993) or Morgan and Bork (1993).

strengthening and enhancing its quality objectives” [Madu and Kuei (1993, p.122)].

The first stage to implementing a STQM system is the planning and policy making. Again, the use of SWOT analysis is advocated by Madu and Kuei (1993, pp.128-130) as “knowledge of the firm’s strengths and weaknesses will enable it to better position itself against its competitors” and develop feasible strategies given its resources.<sup>44</sup> The second stage is to implement strategies on a small scale, considering the risks involved and ensuring the firm is “doing the right thing”. Third, is the evaluation and control of the new system, aiming to ensure that the firm is “doing the things right”. And finally, there comes the full scale implementation of the strategy, where the main objective is to ensure that the firm is “getting the best performance with less resources”. Madu and Kuei justify the use of a STQM system when they conclude as follows: “In the context of Porter’s Value Chain model, protection of the environment is a value-added activity that will yield benefits in the long-run. From a social welfare prospective, the social responsibility of the firm is enhanced”. Again, though, as with Hand (1993), the work of Madu and Kuei (1993) might not be readily applied to the young small firm, where the benefits of STQM might be too far in the future to anticipate, and for whom its implementation may be too costly or time-consuming.

Bamberger’s (1989) work on small and medium-sized firms examines the ways in which they seek to develop competitive advantage. Managers of some 1,135 firms were interviewed using a questionnaire in which a key question was, “On what

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<sup>44</sup> See also Thurston (1983, p.162) who believes that “to plan effectively, business executives must assess company strengths and weaknesses, business and personal objectives, and implementation approaches”.

factors do you put specific emphasis in order to achieve or maintain a competitive position in your main market?" [Bamberger (1989, p.83)]. Respondents were asked to grade a list of 26 given factors<sup>45</sup> on a scale ranging from 'no importance' to 'high importance'. From the results thus obtained, it was established that managers saw their product quality as being a key strength when it came to achieving competitive advantage over their rivals.

Bamberger (1989) presents many factors that have been rated by respondents as being important to their businesses. Whilst it is useful to hear what the owner-managers of small businesses believe, it would have been even more interesting to relate their beliefs to a measure of each factor's actual importance. Further, it would be useful to have an indication of how these beliefs translate into performance, and whether or not responses are modified in the light of experience.

## **2.4 Summary**

Chapter 2 has introduced the literature on strategy, dating back as far as Ansoff (1965), and has thus established the basis for, and put into context, this study of small business strategy. Section 2.2 discusses the works on corporate strategy, from which emerge two distinct schools of thought. First, there are those who recommend a formally structured planning process [*cf.* Ansoff (1965); Porter (1980, 1985)]. These authors believe that firms are able to analyse in detail their environment, and develop detailed plans and strategies based on forecasts and assumptions. Strategies are formulated on the basis of goals and objectives, taking

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<sup>45</sup> Including: product quality; reliability of delivery; reputation of the firm; competence of workers; flexibility of the firm; quality of management; good local image and personal contacts; financial capability; *etc.*



into account the constraints of internal resources available, as well as being aware of external threats or opportunities.

On the other hand, there are the relatively informal methods preferred by the likes of Mintzberg and Steiner. These writers object to the methods of formal structured planning mentioned above, and instead suggest that a firm base its strategies on a 'mission', adapting to the environment as and when needed. They argue that planning far into the future is impossible, as no-one can predict future events with any great certainty, and that the firm that is able to adapt quickly and efficiently will succeed, even if it does not plan or forecast far ahead.

Section 2.3 discusses the literature, including some empirical evidence, on strategy and the small firm, and from this the following points become apparent. First, decision-making in young, small firms appears to be closely linked to the ambitions of the owner-manager, suggesting a 'lifestyle' choice of employment. As the firm grows, the owner-manager has the choice of two options: either retain control, keep growth relatively contained and continue to enjoy the pleasure afforded by being one's own boss; or learn to delegate responsibility, seek extra financing and aim for expansion which, while removing an element of control, and perhaps therefore also enjoyment, might reap larger financial rewards in the long term [*cf.* Storey (1994)].

Compared to the corporate strategy literature, the literature on small business strategy puts more emphasis on the use of business plans. It is argued that, primarily, they serve to clarify the ideas of the owners of a new, small business; but also that they are a useful aid to gaining start-up finance. It is generally acknowledged that new, small firms will have difficulty in producing a plan: first, they have no previous history on which to make predictions; and second, the time

required to develop such plans may be perceived of as 'wasted', when what the owner-manager feels he *should* be doing is getting on with running the business and marketing the product.

When seeking external funding, small firms are typically seen by banks as 'high risk' debtors, so interest rates on loans are often set prohibitively high, and the firm is discouraged from applying for bank financing. Few alternatives are feasible. A charismatic entrepreneur with a novel idea might be lucky enough to attract venture capital or business angel investment but, for most of the rest, their only hope lies with family, friends or the small grants that are available from local authorities or enterprise agencies. Some writers [*cf.* Harris (1993); Hawkins (1993)] suggest that factoring or invoice discounting might be a suitable alternative method of improving cash flow, but there is little evidence to suggest that either of these play a useful role in the financial structure of new, small firms.

The opportunities offered by new technologies are discussed next, and writers on this topic seem to agree that the integration of new technologies into a business is a positive and useful step to take. Advantages are that it can greatly improve the speed and efficiency of communications, to anywhere in the world; rapidly changing technologies open up new niche markets for exploitation by the alert and innovative entrepreneur; and forecasting or generating many possible future scenarios, using computer packages, becomes an easy task, where once it might have taken days, or even weeks, to develop even a simple plan.

Finally, in section 2.3, was discussed the use of quality control in small firms. Basically, a knowledge of one's strengths and weaknesses, an awareness of opportunities and threats, and the ability to monitor and control these attributes will ensure that quality is kept at a level acceptable to the target customers. It

should also assist the small business owner-manager in strategically targeting and protecting a specific niche market. Total Quality Management (TQM) systems, Activity Based Costing (ABC) and the achieving of a approved quality standards such as, for example, the British (now European or International) Standards, were all discussed as possible methods of ensuring and advertising quality. However, with these, as with invoice discounting and factoring, there is not much empirical data to suggest that the use of these systems is either useful or widespread among small firms.

In short, the above analysis has identified several gaps in the existing literature, which will be addressed by this work. It will examine formal [e.g. Porter] versus informal [e.g. Mintzberg] styles of planning, and try to find out which is most successful for the new small firm. It will use first-hand empirical evidence to provide a grounded analysis of factual data. It will establish a multivariate measure of firm performance, to incorporate growth, profitability and productivity. It will relate strategies used to firm performance, in order to provide guidelines for academics, practitioners and policy makers. It will use more than one time period of observations, to permit examination of the outcomes of strategic choices. It will provide detailed qualitative evidence on strategic processes within small firms. And it will question respondents on their beliefs, relate these to performance and examine how beliefs change over time.

This analysis of the literature on strategy has suggested several points that are worth pursuing empirically, which will be examined through the use of an administered questionnaire. This should enable us to discover how relevant are the works on corporate strategy to a new, small firm, and whether or not the findings in the literature on small firms are equally valid for the micro firm in Scotland.

This thesis will address such issues, by investigating the experience of micro firms in Scotland, using fieldwork methods to develop an empirical body of data, providing factual evidence rather than theoretical assumptions, and in this way, it is hoped, providing a valuable addition to the existing literature in this field. Chapter 3 now goes on to discuss the methodology behind the study.

# Chapter 3

## Fieldwork: sample and questionnaire design

### 3.1 Introduction

Chapter 3 introduces the methodology used in collecting the data for this study. First, the means of establishing the sample of firms for interview is explained by reference to meetings with Directors of Enterprise Trusts. These meetings are shown to provide an overview of new small firms in Scotland. The method of sample selection is justified with reference to the relevant literature, and it is shown how conversations with Directors were instrumental in the design of the administered questionnaire.

Second, the reasons for using an administered questionnaire are explained, and the section relating to Business Strategy is analysed in detail. The questions in the administered questionnaire are described, as is the reasoning behind their inclusion and the issues they are intended to address. Again it is shown how questions are related to comments made during conversations with the Enterprise Trusts, and also by reference to the literature.

Next, the interviews themselves are discussed. Reasons for the pilot study are explained, then the way in which firms were approached for inclusion in the main study is laid out. The timescale for interviews is also discussed here, as is the importance of the development of a good working relationship between the research centre and respondents.

Following the discussion of the administered questionnaire and of its implementation, an outline of the semi-structured questionnaire and its development is included. It is shown how the new format was used to develop detailed case studies of a subset of the original sample of firms, with reference to the process of strategy formulation and choice followed in these firms. There is then a discussion of the questions covered during these additional meetings, and the reasons for their inclusion, followed by a description of the methods used to elicit respondent's cooperation.

### **3.2 Establishing the Sample**

One aim of the study was to incorporate as wide a range of firms as possible, in terms of regional diversity, but at the same time it was essential that the sample should be random, in order that assumptions could be made about the population as a whole. Sekaran (1992) discusses reasons for and benefits of taking a sample from the population.<sup>1</sup> Because there is no national register of start-up firms in Scotland, another source had to be found to establish the sample. The Enterprise Trusts were the natural choice, as they are often the first port of call for a budding entrepreneur seeking to start up a new venture. Table 3.1 describes some of the aims of various Enterprise Trusts, as taken from their promotional literature used to attract new business ventures. We can see that they place a strong emphasis on helping firms to grow and become more profitable concerns, for their own good as well as for the local economic community. The method of sample selection

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<sup>1</sup>See Sekaran (1992) Chapter 8: Sampling.

## GOALS OF THE ENTERPRISE TRUSTS

Table 3.1

The Enterprise Trust aims to:

“...encourage the growth and development of both new and existing businesses”

*Strathkelvin Enterprise Trust*

“...aid your company to a more successful and profitable future”

*Glasgow Opportunities*

“...provide assistance for expansion and survival plans for small and medium sized enterprises”

*North East Fife Enterprise Trust*

“...provide help and support for the smaller business, both new and expanding”

*South Fife Enterprise Trust*

“...improve the economic outlook and employment prospects for Clackmannanshire ... to build on the strong manufacturing traditions of the area and play our part in developing a diverse and environmentally responsible local economy which can be sustained”

*Alloa Clackmannanshire Enterprise*

“...[help] you to get your business right”

*Falkirk Enterprise Action Trust*

**Source: *Enterprise Trust Promotional Literature***

described above was previously used with success by Reid (1993)<sup>2</sup>, and a good reputation in the field was to prove beneficial for this study.

A contact at Scottish Business in the Community (SBIC) was a great help in familiarising the ‘team’<sup>3</sup> with current practice within the Enterprise Trust movement in Scotland. A meeting was held at the SBIC offices in Edinburgh, during which the team were advised as to who might be the most helpful contacts. A general discussion was had about the role of the Enterprise Trusts in helping small firms to become established, and a list of Scottish Local Enterprise Trusts, together with the contact name of the relevant Director, was provided to form the basis for sample selection.

Following this meeting, a random sample of 15 Enterprise Trusts was drawn up to provide the sample of 150 firms.<sup>4</sup> It was originally intended that 12 firms from each Enterprise Trust should make up the sample, thus allowing a comfortable safety margin to cover for those firms unwilling to participate, unable to be traced, or even already out of business.

In practice, the sample of Enterprise Trusts had to be broadened. Regimes vary widely across the Enterprise Trust movement: some had records which proved to be out-dated, whereas others kept a close eye on the firms they had helped; several of the provided firms were “too busy” or unwilling to help, usually those who had not been contacted previously by the Enterprise Trust about their willingness to

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<sup>2</sup>See also Reid (1987) *Applying Field Research Techniques to the Business Enterprise*, in which he describes in detail the methodologies he has used in his own previous research.

<sup>3</sup>Here, ‘team’ refers to Professor Gavin C Reid and Miss Julia A Smith.

<sup>4</sup>It should be mentioned here that the Highlands and Islands were excluded from the sample for reasons of practicality (e.g. remoteness, financial constraints) and because the Enterprise Trust structure in this area differs quite significantly from that in the rest of Scotland. See, for example, Reid (1992b) *Small Firms, Finance Gaps and Venture Capital*, in which he reports upon the differences in funding shortages experienced between small firms in the Highlands and Islands compared with those in the rest of Scotland.



become involved in the study; and 14 of the original sample were used for a pilot study. Further Enterprise Trusts were therefore contacted, resulting in a sample which covered practically the whole country, and provided the 150 firms for the main study. Table 3.2 details the areas covered by these 150 firms, and Figure 3.1 shows the interview clusters, indicated by circles superimposed onto a map of Scotland. It is clear to see that the Enterprise Trusts selected gave a good coverage of the most densely-populated areas of the country, ranging from as far North as Gordon Enterprise Trust in Inverurie, through the central belt of Stirling and Falkirk, down as far as Cumnock & Doon in the West, and Midlothian in the East.

#### *Meetings with Directors of Enterprise Trusts*

In order to acquaint the Enterprise Trusts with the purpose of the project, to reassure them of the professional conduct of the investigators, and also to learn about regional diversity and traits, meetings were held with the Directors. These meetings, although generally unstructured, can be broken up under the broad headings of *Introduction*, *General Discussion* and *Request for Sample of Firms*. Sekaran (1992) describes the advantages to be gained from conducting unstructured interviews. The interviewer starts without a questionnaire or any planned agenda, but instead asks broad questions which are intended to “surface some preliminary issues so that the researcher can formulate a good idea of what variables need further in-depth investigation” [Sekaran, 1992, p.190]. At the initial stage of a project, therefore, unstructured interviews can be instrumental in the formulation of a structured questionnaire.

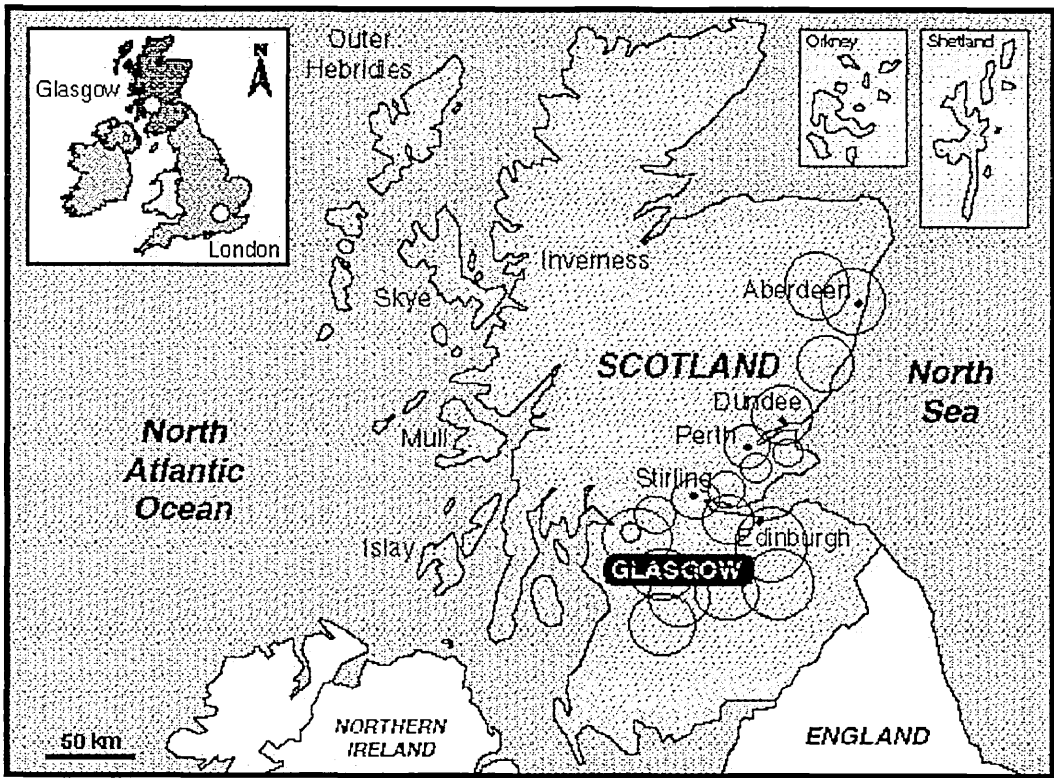
## AREA COVERED BY THE STUDY

Table 3.2

REGION	ENTERPRISE TRUST
GRAMPIAN	Gordon Enterprise Trust Aberdeen Enterprise Trust
TAYSIDE	Angus Enterprise Trust Dundee Enterprise Trust Perthshire Enterprise Company Ltd
CENTRAL	Stirling Enterprise Park Alloa Clackmannan Enterprise Ltd Falkirk Enterprise Action Trust
FIFE	North East Fife Enterprise Trust South Fife Enterprise Trust
LOTHIAN	The Capital Enterprise Trust Midlothian Enterprise Trust
STRATHCLYDE	Glasgow Opportunities Govan Initiative Strathkelvin Enterprise Trust Clydesdale Development Company Ltd Hamilton Enterprise Development Company
BORDERS	Cumnock & Doon Enterprise Trust

# INTERVIEW CLUSTERS

Figure 3.1



*Note:* The circles on the map indicate the areas around which the interviews were clustered.

The interviews with Enterprise Trust Directors shall now be discussed under the previously defined headings.

*(i) Introduction*

The aims of the main project were explained, and the reasons for the research clarified. It was also mentioned that a separate study on Business Strategy was to be carried out. The reactions of the Enterprise Trusts were generally favourable, with comments such as “we will obviously be interested in the study”, “I’m not aware of many consultancies or people doing these types of studies” and “they [small firms] occasionally like to talk to people - they feel flattered”.

The Directors were typically keen to assist in the study, and were especially interested in receiving, in due course, summary results, particularly with regard to their own area. To encourage their cooperation, it was therefore explained that annual summary reports would be distributed to those who had helped and that, eventually, Discussion Papers would also become available.

*(ii) General Discussion*

Once the basis of the study had been explained, the meeting led on to a general discussion of entrepreneurship in the area covered by the individual Enterprise Trust, and the experience of start-up firms in the region. Directors were asked what they thought might be points worth investigating, and comments they made were taken on board when it came to writing the questionnaire. This was intended to make them feel that they were taking a part in the project, and that the results would therefore be of more relevance and interest to them. It also assisted the

interviewers in getting a feel for the environment in which small firms were operating.

One Director said that “the Enterprise Trusts have been criticised for saying that self-employment is an alternative to unemployment” while another admitted dealing with “the unemployed who start their own business as a means of employment”. Another possible reason pointed out for starting up a new venture was that some people, for example, might “break away from a company to set up a subsidiary of it”, but Enterprise Trusts found that these businesses typically had more trouble in gaining financial support. This posed the question: why did the entrepreneur himself choose to start up a new business and what did he hope to gain from it? One of the interviewees expressed the following concern: “We’ve become a bit disturbed because people think about survival first and foremost, not about expanding”. How true, in fact, was this statement to prove?

Questions on financing were prompted by comments such as “We would put people towards venture capital” and “one or two private investors have shown an interest”. It was also said, though, that “when talking about private sector involvement and risk/return received, the business angel<sup>5</sup> becomes almost a predator”. How then, in practice, do small businessmen finance their operations, and are venture capitalists and these so-called ‘business angels’ used at all? The administered questionnaire sought to answer this question.

One Director lamented the “lack of aggression and effective market research” carried out by small businesses, concluding that “maybe it does not exist”. He also

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<sup>5</sup>In *The Venture Capital Report Guide* Lucius Cary describes Business Angels as follows: “Business Angels are rich individuals who invest in small companies ... are likely to be actively involved in the businesses in which they invest ... [and usually] ... become a director of the investee company”. [Cary, 1995, p.684]

remarked upon the inability to “have a market and to capitalise on it”, adding that “people have good ideas, but the ability to capitalise on potential does not exist, especially in export market opportunities”. Another said that, “in our experience, clients who come through this programme gain from networking and social contacts”. Together these comments helped to suggest questions on gathering trade intelligence on rivals, self-analysis and awareness of strengths, weaknesses, opportunities and threats, including here the possibilities offered by the breakdown of barriers to trade in the European Community. The administered questionnaire would look into where and how the entrepreneur gathered his information.

The administered questionnaire was to probe quite deeply into the entrepreneur’s awareness of strengths, weaknesses, opportunities and threats, following comments such as “very few actually do long-term planning or SWOT analysis”. One Director thought that “the main constraints are the red-tape put in place by those who are said to be there to help small businesses”, and another believed that small businesses had “a mental block against bureaucracy (the SDA<sup>6</sup>, Local Development Boards, and so on) who never deliver on their promises”. These items were therefore to be incorporated into the SWOT analysis that respondents were asked to complete to see if the problems of small businesses as perceived by Enterprise Trust Directors matched with those of the entrepreneurs themselves.

“Financial handling is not a great problem - it is always achievable and can be taught” is a comment that led to questions about seeking outside advice or buying-in expertise in order to achieve certain tasks or help in developing new business strategies. For example, would the entrepreneur attempt to handle all accountancy

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<sup>6</sup>Scottish Development Agency.

and insurance matters himself, or would he rather seek outside help, which could either involve free training and advice from the Enterprise Trust, or the paid for assistance of a professional accountant. The observation that “they need training in areas other than their craft [such as] general management and financial control, [but] to get the small business enterprise to understand the benefits of training is often quite difficult” was also instrumental in the design of the questionnaire.

One of the people interviewed said that the “Enterprise Allowance was an employment measure at one time [but] over the last two years it has become more of an enterprise measure.... [Now] there is less money, but we are spending more on supporting firms [who in turn] are treating it more as a business [and] are making, understanding and using a business plan”. Contrast this with the Director who said that “business plans have been debased, and are now worthless. It used to be an indicator of endeavour”. These remarks were to prompt questions on business plans as well as, again, reasons for start-up. Do entrepreneurs have business plans; if so, why are they formed, who is involved in writing them, and are they subsequently used?

Some Directors seemed to be in favour of small businesses developing quality systems saying, for example, “[in this area] they typically have no management or marketing experience. They have good job skills but need to introduce quality systems”; and “the greatest problem is to get people to understand that they can improve their business by increasing managerial skills”. However, others seemed less supportive of such plans, which take both time and money to implement, saying “I don’t agree with BS5750, ‘hoop-jumping’, and so on, when the business is there to make money”.

These interviews covered many topics and uncovered useful points, which were during the process of designing the questionnaire. Directors were obviously keen to be kept informed about the progression of the firms they had helped to support. Typically, they lose contact with firms after the initial year or so of involvement, and any insight to be gained from the long-term tracking used by this study would be both helpful and informative to them. They were therefore extremely cooperative and enthusiastic about the work to be carried out.

### ***(iii) Request for Sample of Firms***

Once the Directors had been made aware of the project and were sufficiently comfortable with its aims, they were asked to provide a random sample of the firms on their client list. The only conditions put on this sample were that the firms should be less than three years old, and that they should have started up through the Enterprise Trust. It was also important that the sample be representative. In other words, if the client list was grouped into those who had started up because of unemployment, compared with those who had left unemployment to start, for example, a subsidiary of their previous firm, as was the case in at least one Enterprise Trust interviewed, then the sample should be stratified proportionately to reflect this.

Sekaran (1992, p.233) outlines the benefits of stratified random sampling: it “involves stratifying the elements along meaningful lines and taking proportionate or disproportionate samples, from the strata. This sampling design is more efficient than the simple random sampling design because, for the same sample size, we get more representativeness from each important segment of the



population”. By following this format for each Enterprise Trust approached, the best random sample could be, and was, achieved, as far as was possible.

Many Enterprise Trusts had records held on computer databases and it was therefore a fairly simple task for them to pull out a random sample of 15 to 20 firms. There were, however, occasional conflicts where, for example, other researchers had been active in the field and respondents were likely to be subject to ‘survey fatigue’. On these occasions, the Enterprise Trusts took a little longer, but eventually delivered a list of randomly selected firms that they considered would be ‘survey happy’, and willing to cooperate in the study.

Given that this work is a subset of the larger study of Reid, the investigator had little control over the sample of firms to be examined.<sup>7</sup> However, there is purpose to be served by exploring the extent to which the sample is representative of Scottish firms in general, and the level of confidence that can be had in the statistical inferences made throughout this work. First of all, 150 firms is certainly a sufficient number to constitute a statistically ‘large’ sample, as defined, for example, by small sample distribution theory.<sup>8</sup>

Second, recent figures released by Scottish Enterprise (1996) suggest that the sample corresponds very closely to the much larger picture of new Scottish firms in the 1990s. For example, by legal form, the 1993-94 sample used in this study comprised 26% sole traders working from home, 29% sole traders operating from business premises, 19% partnerships and 27% private limited companies. The Scottish Enterprise figures for 23,000 new firms in 1996 give sole proprietorships

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<sup>7</sup>The sample was originally defined in Reid’s project proposal submitted to the Leverhulme Trust in early 1993.

<sup>8</sup>From the perspective of the student t-distribution sample sizes above 70 are effectively ‘large’ samples.

at 48%, partnerships at 21% and limited companies at 30%.<sup>9</sup> The categories, although slightly different, show clearly that there is a high similarity of breakdown by legal form between the two samples.

The division by sector is a slightly more contentious issue, but is nonetheless still worth addressing. Scottish Enterprise state that 68% of new businesses in Scotland in 1996 were in services, compared to 64% in this study [*cf.* Chapter 4].<sup>10</sup> Figures from the Department for Education and Employment suggest that, for the UK as a whole, “service sector firms represent just over 70% of all small firms in the economy” [*Labour Market Quarterly Report* (1996, p.11)].<sup>11</sup> However, it is often very difficult to classify firms by sector, as it is the product, and not the business, to which the SIC applies. Some firms, offering different products or services, may be identified by two or more sectors, and it is not uncommon for firms to fall into both the services and manufacturing divisions.

The focus of this work is not on identifying individual strategies associated with the many varied sectors into which small firms fall. Indeed, such a task would be time-consuming and arguably futile. Instead, the study aims to identify generic strategies which may be applied equally to any young micro firm. This should prove more useful to policy makers, for example, who cannot possibly afford the time or money required to create policies for each class and type of small firm but, instead, are looking to devise incentives and assistance that can apply to any new

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<sup>9</sup>Storey (1994) reports on the findings of Bannock and Partners, who calculated that, in 1986, for the UK as a whole, 55% of small firms were sole proprietorships, 26% partnerships and 19% limited companies. By 1989, Daly & McCann (1992) found a similar breakdown of UK firms by legal form.

<sup>10</sup>Again, the Scottish Enterprise categories vary slightly in definition from those used in this study.

<sup>11</sup>See Reid (1993, Chapter 1) for detailed comparisons of the Scottish small firms sector with that of the UK.

young business.

In terms of legal form and industrial classification, there can be relatively high confidence that the sample is representative of Scottish firms, although admittedly there may be slight bias towards firms with greater start-up support. For example, this study uses the Enterprise Trusts for the sampling frame, and the Scottish Enterprise figures are based on bank records, both of which show that the firms in question had either advice or financial support available to them from an early stage. However, it may be that the regime in Scotland is currently very supportive of new businesses generally, and it is cheering to note the similarities, given the difference in sample size (*viz.* 150 compared to 23,000). It is with some confidence, therefore, that the sample is used to provide a representation of new micro firms in Scotland in the early 1990s.

### **3.3 The Administered Questionnaire**

As has already been mentioned, the administered questionnaire was developed following extensive reading of the relevant literature and conversations with the Directors of Enterprise Trusts. The main project involved a lengthy and detailed questionnaire covering seven main topics, one of which, devised especially for this particular study, was *Business Strategy*, and it is mainly upon this section that this work is based.<sup>12</sup> Table 3.3 summarises the points covered by Section 4 of the questionnaire, on Business Strategy, discussed in detail below. The full section

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<sup>12</sup>The main headings of the administered questionnaire were: *Market Data*; *Finance*; *Costs*; *Business Strategy*; *Human Capital*; *Organisation*; *Technical Change*. This study also draws upon various data (for example, performance data such as turnover or profits) from sections other than that of *Business Strategy*. See Appendix II for the actual questionnaire.

## SUMMARY OF ADMINISTERED QUESTIONNAIRE

### SECTION 4: BUSINESS STRATEGY

**Table 3.3**

#### *Aims, Ambitions and Making Decisions*

- reasons for becoming involved in the business
- main aim of the business
- personal vs financial decisions
- considering the experience of others when making decisions (strategic and operational)
- autonomous decision vs negotiated decisions
- strategies formulated in-house vs outside advice sought

#### *Forward Planning*

- existence of a business plan
- formal, written plan vs idea held in the head of the entrepreneur
- people involved in writing the plan
- frequency of revision of plan
- how far ahead entrepreneur plans

#### *Funding Growth*

- preference for capital injection vs restructuring existing financial operations
- methods of restructuring debtors and creditors payback terms
- previously used sources of finance
- willingness to give up a percentage of equity to promote growth
- willingness to accept smaller profits to aid expansion

#### *Information, Technology and Communications*

- feedback from customers actively sought or given freely
- actions taken as a result of customer feedback
- entrepreneur's gathering of information on rivals' activities
- form, regularity and methods of information gathering
- importance of information technology to the business
- kinds of information technology used, and its applications

#### *Quality Control and SWOT Analysis*

- total quality management systems installed
- benefits of total quality management system
- formal quality approval gained for products, operations, personnel, business as a whole
- benefits of quality approval
- analysis of strengths, weaknesses, opportunities and threats

from the administered questionnaire is held in Appendix II, with the results inserted from years one and two.

The use of an administered questionnaire permits the gathering of an extremely large number of data points which can be readily coded and entered onto a computer database. From then on the data can be manipulated without much effort, and they are easily transferable from one piece of software to another. Specific items may be 'pulled out' and treated individually, or compared with data from other sections. An administered questionnaire is also easier to complete quickly, with respondents having to pick one of several possible answers rather than come up with a solution themselves. Consistency is thus established within the sample and such results between firms are more easily and legitimately compared. Consequently, data from large sample numbers of firms can be assimilated and broad comparisons drawn. Average impressions can be given of the survey sample as a whole and summary statistics reported upon. Firms which vary widely from the average can then be readily identified and analysed further if desired. An administered questionnaire is a good way of establishing a large database which can be either expanded or compared easily with other studies. It provides a detailed and easily manipulated set of primary source data and is therefore a valuable reference containing much useful information.

Personal contact is a key factor in the success of administered questionnaires. The response rate is likely to be much higher with a personally conducted face-to-face interview than with, for example, a mailed questionnaire, which may simply be thrown away. Results should also be much more accurate as a well-trained interviewer, who understands the questionnaire, is able to reply to and explain respondents' queries about meanings and exact requirements of the questions. The

interviewer is able to build a rapport between himself and the respondent, and can encourage frank and honest answers as far as is possible. Thus, working together, a much more accurate response is achieved than might otherwise be the case.

Sekaran (1992, p.220) conveniently summarises the advantages of face-to-face interviews: they “provide rich data, offer the opportunity to establish rapport with the interviewees, and help to explore, and understand complex issues. Many ideas that are ordinarily difficult to articulate can also be surfaced and discussed during such interviews”. The administered questionnaire developed for this study kept the interviewer to a strict agenda, but room was made for observations where it was felt that the respondent might wish to expand upon a point. There was thus established a rich and detailed body of quantitative data, complemented, where relevant, with additional qualitative data, which was both informative and interesting.

#### *Aims, Ambitions and Making Decisions*

Section 4 of the administered questionnaire, on Business Strategy [*cf.* Table 3.3], shall be discussed under the same headings as have been used earlier in this work; first, under that of *Aims Ambitions and Making Decisions*. The respondent was asked why they first became involved in the business in question. The objective here was to find out whether the business was started up out of necessity, out of some ambitious need to succeed, or simply as an enjoyable pastime that would bring in a small income. The question was prompted partly by the work of Cooper (1993)<sup>13</sup>, and also by that of Bamberger (1983). Next, respondents were asked

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<sup>13</sup>References throughout this chapter are to the literature discussed in Chapter 2.

about the main aim of the business. Here, the respondent could choose from a list of answers which ranged from very short term objectives, such as plain survival, to rather more long term ambitions such as an increased market share or high rate of return. On a similar vein to these questions, the respondent was asked to say what percentage of decisions were made for personal reasons, and what percentage for financial reasons. Again, this was intended to give an idea of the aspirations of the owner manager, and was linked to the aims of the business.

Respondents' awareness of rivals was being examined when they were asked whether, when making decisions, they took into account the experience of other businesses similar to that of their own. The question was asked with respect to both strategic and operational decisions, to establish any difference between decision making in the long term and that in the short term. Did the entrepreneur learn from the mistakes made by others, or did they continue, blissfully unaware, down the same road they had gone previously? Another question was concerned with whether decisions were made by a sole individual or whether they came about through discussion and negotiation with others. Again, this question was asked for both strategic and operational decisions, and follows from Mintzberg's (1991), who points to the advantages of having a single charismatic leader.

Finally in this section, respondents were questioned about their development of new strategies. For various activities they might be required to perform (for example, new investment, marketing, accounting matters), would they consider seeking outside advice, as recommended by Hay *et al* (1993), or would the appraisal be carried out 'in-house'? Further, if they were willing to obtain outside help, would they also be willing to pay for it? Work by Johnson and Devins (1994) suggests that they would. These questions sought to discover how keen the

entrepreneur was to seek out the advice they needed, either through training or bought-in expertise. It was also intended to establish whether or not the business had within it the internal capabilities to carry out key functions of management.

### *Forward Planning*

Respondents were asked whether or not they had a business plan, and if they did, was it a formal, written plan, advantages of which are noted by Baker *et al* (1993), and who was involved in preparing it? The aim here was to establish whether the respondent had decided to write such plan under their own initiative, or whether it had been written because it was said to be a 'good thing to do', as is recommended by the *National Westminster Bank* (1992); or was such a plan formed simply because it was necessary to obtain financial support such as the Enterprise Allowance, grants or low interest loans?

The questions that followed were intended to help to establish the reasons for developing a business plan. The respondent was asked first of all how often the plan was reviewed. It was thought that responses such as 'never' would 'weed out' those who had formed a plan simply to gain start-up support. On the other hand, it was considered that those who made frequent reference to their plans, with regular reviews of it, would prove to be those who knew the value of having and following structured plan, and were more likely to have written it of their own accord.

Related to this question was another about forward thinking. How far ahead does the small businessman look when considering the impact that planned decisions might have? Do they, as is often thought, worry only about where the money is coming from to pay the next bill? Or do new small ventures have the



inclination and capability to plan further ahead, a procedure Mount *et al* (1993) believe small firms should adopt?

### *Funding Growth*

This section enquired as to how the entrepreneur was willing to finance their business. If an improvement in cash flow were required, would they rather inject more capital finance into the business, either from their own funds or from, for example, a venture capitalist; or would they seek to restructure the payback methods of their debtors and/or creditors? The latter offered various choices to the respondent. For example, it might be that they would contemplate various factoring or invoice discounting arrangements, which Hawkins (1993) believes can assist a small business during the early years of its life; or perhaps they would rather extend their credit with suppliers, or cut down on the credit allowed to their customers.

The respondent was then asked which methods of raising finance they had actually used in the past. This ranged from choices such as 'personal financial injection' to 'venture capital' and 'business angel' equity stake. This question sought to discover which options of funding their operations new small firms were aware of, had access to and had used, and further options in the question were prompted by Reid's (1995b) work. For example, did they rely on bank loans and money from friends or family, or were reinvested profits a major source of finance.

Respondents were next quizzed about their willingness to grow the business. Would they be willing to dilute their equity holding, as favoured by Bhidé (1994), if this would increase possibilities for business expansion, for example by taking on a partner willing to inject capital finance. Alternatively, was the urge to remain in

control of their own destiny such an overriding concern that any decrease in share ownership would not be considered [*cf.* Storey (1994)]? If they *were* willing to give up a percentage of equity, what would be the minimum share that they would wish to continue to hold? Would they want to remain in control, with no less than 51 per cent, or would they be willing to go lower than that, for the good of the business? Along the same line, another line of questioning was concerned with whether respondents were agreeable to accepting smaller profits if this could aid expansion.

### *Information, Technology and Communications*

In the previous chapter, the importance of information to the development of a competitive advantage was stressed. This led to the inclusion of a number of questions designed to provide data on how information is collected and used by new firms. This section of the questionnaire therefore started off with a question about customer feedback. Customer service and their satisfaction is obviously of paramount importance to any business, large or small. Is the small-firm manager aware of customers' reactions to his product or service, through feedback, and do they actively seek this information or merely accept it when it is offered? The follow-up question enquired into what use, if any, was made of the information gained from customers.

Further to this investigation of the entrepreneur's awareness of the actions and opinions of those who might affect his business, respondents were then asked if trade intelligence on rivals was actively sought. Trade intelligence was broken down into several different categories of information that a business might wish to know about his competitors, for example on their new products, and product

quality, to discover in detail how much information was gathered. They were also asked how regularly this activity was carried out, and from which sources this information was taken.

Questions on *Information Technology* took Porter and Millar's (1991) definition<sup>14</sup> as a starting point, when asking how important information technology was to the small business. Respondents were then asked to identify, from a list of various possible sources of information technology, those which they used during the course of his business, and subsequently what they used information technology for. This latter question included the option of 'networking', amongst other things. The aim of these questions was to discover how great an effect information technology is having on new Scottish businesses, and to identify its uses. They were also intended to show whether networking in Scottish firms has improved along with rapidly improving technologies, or whether it has remained at a level inferior to that of, for example, its US counterparts.<sup>15</sup>

### *Quality Control and SWOT Analysis*

In this final section, the goal was to identify Total Quality Management (TQM) systems, such as those reported upon by Hankes (1993a,b) that may have been implemented by the small business. Respondents were also asked, where relevant, why they considered that the installation of such a system was important to their business. They were then further asked whether any other formal quality approval (for example, British Standard BS5750) had been sought or achieved for each of

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<sup>14</sup>See Chapter 2: Strategy, for this definition.

<sup>15</sup>See McNicoll (1994) for an empirical study contrasting networking between would-be entrepreneurs in Scotland, and those in Boston, Massachusetts.

their products, operations, personnel or business as a whole; and again, what they hoped to gain from having achieved such approval.

The purpose of these questions was, first of all, to see if new small firms in Scotland are aware of and implementing quality controlled systems, be it to improve motivation, gain a better image, increase efficiency, achieve greater cost control, or for some other reason. Ample room was allowed here for extra comments and details of any awards achieved. In addition, it was hoped to elicit a general opinion of such systems. Those who advise businesses are often heard to advocate quality systems, but what do small businesses themselves make of these systems? Do they consider them to be of use, or do they rather see them as expensive, time-consuming and ultimately restrictive controls? It was hoped that the administered questionnaire could shed some light on this topic, under-researched as it is for the case of the small firm.

Last, although it was not identified specifically as such, a SWOT analysis was carried out for the respondent's business, such as that recommended by Madu and Kuei (1993), who find that an awareness of the strengths and weaknesses of the firm can confer upon it the advantage of knowing how to position itself in the market vis-à-vis its competitors. Respondents were provided with three sheets upon which to tick their responses. First, they were required to rate a list of items<sup>16</sup>, as they related to his business, on the scale 'good', 'fair' or 'could be better'. This latter response was substituted for 'bad' after piloting suggested that respondents might be unwilling to agree that any aspect of their business was

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<sup>16</sup>Including: adaptability, faith in the business, foresight/forward planning, values of management, plant and resources, managers, employees, product quality, product range, organisations structure/systems, sources of finance, customers, suppliers, market share, technological/specialist know-how, innovativeness/new ideas, image.

anything less than satisfactory. From the 17 answers, the respondent was then asked to identify the single biggest strength and weakness of their business, as they perceived them; unless of course something other than those on the given list were applicable.

Similarly, the second sheet addressed potential threats to the business. It considered therefore mainly rivals, and included most of the previous list's options, but with relation to rival firms. Thus the respondent was asked, for example, to say whether rivals' adaptability was considered to pose a 'weak', 'medium', or 'strong' threat to their own business. This sheet also included some additional items which did not fit easily into the previous sheet.<sup>17</sup> In this case, the respondent was asked to identify the single biggest threat to their business.

Finally, the respondent was handed a sheet on which were listed various items that might offer opportunities, for example, for expansion, increased profitability, entering a new market niche, and so on. They were asked to mark for each item, as it was in their own business, whether they thought it offered 'a lot', 'some' or 'no' opportunity. This sheet included a combination of the items listed in the two previous sheets. Thus the respondent was asked, for example, the extent to which the breakdown of barriers to trade in the European Community offered an opportunity to their business. Finally, they were asked to identify what they thought to be the greatest source of opportunity.

These three concluding sheets would obviously generate an immense amount of data. A 'not applicable' column was included on each, which respondents could choose if the item did not relate to their business (for example, no employees), or if

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<sup>17</sup>Including: 'red tape'/government legislation, breakdown of barriers to trade in the European Community, substitutes, and competition in general.

they were unaware of their rivals' activities (for example, rivals' forward planning). It was therefore anticipated that responses to these questions would help to identify those businesses who did not keep a watchful eye on the competition and might be liable to succumb to unanticipated threats. It was also thought that respondents' perceptions might change as the business progressed. For example, a naïve respondent who rated their business 'good' for almost everything might, with another year's business experience, rate each item more realistically if performance had been poor. It was considered that the more realistic the appraisal, the better performance might be. An awareness of the firm's strengths, weaknesses, opportunities and threats can help to identify problems that need to be tackled, and early corrective action should prove to be beneficial in the long run.

The single biggest strength, weakness, opportunity and threat identified by the respondent could be followed up at a later point. So if, for example, someone identified their adaptability to be the firm's biggest strength, then they could be asked, in a semi-structured interview, how this was used to gain marketplace advantage. This was also true for the remaining responses.

### **3.4 The Administered Interviews**

#### *Pilot Study*

During the early months of 1994, a pilot study of 14 firms was conducted. There were several reasons for this. First, the questionnaire had to be tested in 'real' situations, to ensure that it read well, was comprehensible, and gave the information required. At this stage, a casual research worker was drafted in to

augment the team<sup>18</sup>, and initial interviews were carried out with all three people involved in the project present; one to conduct the interview, and two to take notes for later discussion. Following an interview, the team then compared notes, any necessary amendments were made to the questionnaire, and the new version was used for the following interview. These early interviews helped to restructure or rephrase questions, suggested where show cards<sup>19</sup> might be necessary, and prompted additional alternatives in multiple-choice questions.

In addition, the pilot study was used as a training ground for the interviewers, who took it in turns to administer sections of the questionnaire, gaining in confidence and fluency as they became more familiar with the layout and order of the questions. It was important too that the interviewers become accustomed to replying to respondents' questions and that they understand and be able to explain exactly what was wanted. Piloting helped to answer any queries and surface any problems early on. During this initial period the questionnaire was amended and improved, and only when it was thought that all problems had been ironed out, and that interviewers were well-trained, did the main study interviews proceed.

### *Main Study*

The 150 interviews that constituted the first year's sample were completed within the period April 1994 to May 1995. The same pattern was followed for each sample of firms in the main study as for those in the pilot study. First of all, a

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<sup>18</sup>Sekaran (1992, p.193) remarks that "when several long interviews are to be conducted, it is often not feasible for one individual to conduct all the interviews [and] a team of trained interviewers then becomes necessary". This was indeed the case in this study.

<sup>19</sup>Show cards are handed to respondents in questions where, for example, long lists of alternatives are used. They facilitate understanding, act as a visual aid and can be used as a sheet for ticking responses.

preletter was sent from CRIEFF<sup>20</sup> to each firm on the list. This letter described briefly the aims of the study, explained the involvement required of each participant, told from which source their name had been obtained and promised annual reports for all who agreed to take part.<sup>21</sup>

The preletter was followed by a telephone call, typically to the owner manager direct, to arrange a date and time for the interview. In general, the interviews were held at the respondent's place of work, which was often their own home, although one or two chose to come to the research centre, and others occasionally suggested meeting on mutual ground, for example, in a local café. The questionnaire was fairly lengthy and took anything from between 50 minutes and two hours or more to administer. On average, though, it could be covered comfortably in just over an hour.

To allay any fears held by respondents, it was stressed at all times that confidentiality would be respected. Throughout the fieldwork process, from gaining sample lists of firms, to arranging meetings and eliciting the agreement of owner managers to participate, right through to interview, data collection and follow-up 'thank-you' letters, confidentiality was a key word in establishing a trusting relationship between interviewer and respondent. If the firms felt at ease with the process, it was thought, they would be more likely to divulge detailed information. Knowing that they would only be identified by one number among 150 meant that they need have no worries about customers', suppliers' or rivals' reactions to the findings of the study, and this helped to put them more at ease.

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<sup>20</sup>Centre for Research into Industry, Enterprise, Finance and the Firm, Department of Economics, University of St Andrews.

<sup>21</sup>Advantages noted by Reid (1987) of sending out preletters include a lower refusal rate and increased cooperation.



Following an interview, respondents were sent 'thank-you' letters. Where particular interest had been shown in the results or future use of the data, a complementary sample of previous work in the area was sent to give an idea of what might result from the study. A good relationship with respondents was therefore developed and it was hoped that this would maintain their cooperation over the remaining life of the study.

The second year of interviews commenced immediately after the first ended. An amended preletter was again sent to respondents, but this time it was accompanied by a summary report of the first year's findings. This provided respondents with an idea of the environment in which they, as small firms, were operating, and enabled them to identify whether they were performing any better or worse than other, similarly-sized firms. It was expected that this would captivate their interest and encourage them to continue their cooperation.

### **3.5 The Semi-Structured Questionnaire**

The administered questionnaire was developed with the aim of generating a large body of quantitative data on which could be performed statistical and econometric analyses and, as such, it was to prove successful. However, in order to illustrate in a more discursive fashion the experience of various firms in their planning or decision-making procedures, a semi-structured questionnaire was developed. The intention was to create an additional number of case studies, of firms included in the original sample, and to link the perceived trends from a qualitative analysis of these cases to the quantitative findings of the administered questionnaire.

The use of two questionnaires is not uncommon amongst researchers. For example, Miles and Huberman (1984, p.151) point out that "qualitative researchers

are using multisite, multicase designs, often with multiple methods”. Sekaran (1992, p.219) agrees that “good researchers try to obtain data ... through multiple data-collection methods”. The main advantage is that, while the administered questionnaire allows us to identify tendencies for the larger full sample, using statistical analysis, the semi-structured interview schedule permits further probing of already observed tendencies, and generates detailed descriptive evidence. As with the administered questionnaire interviews, face-to-face meetings with respondents, using the semi-structured questionnaire, are important for the reasons outlined previously [*cf.* Section 3.3 above]. These include the clarification of any doubts by the interviewer, the ensuring of the respondent’s comprehension, and a higher rate and accuracy of responses.

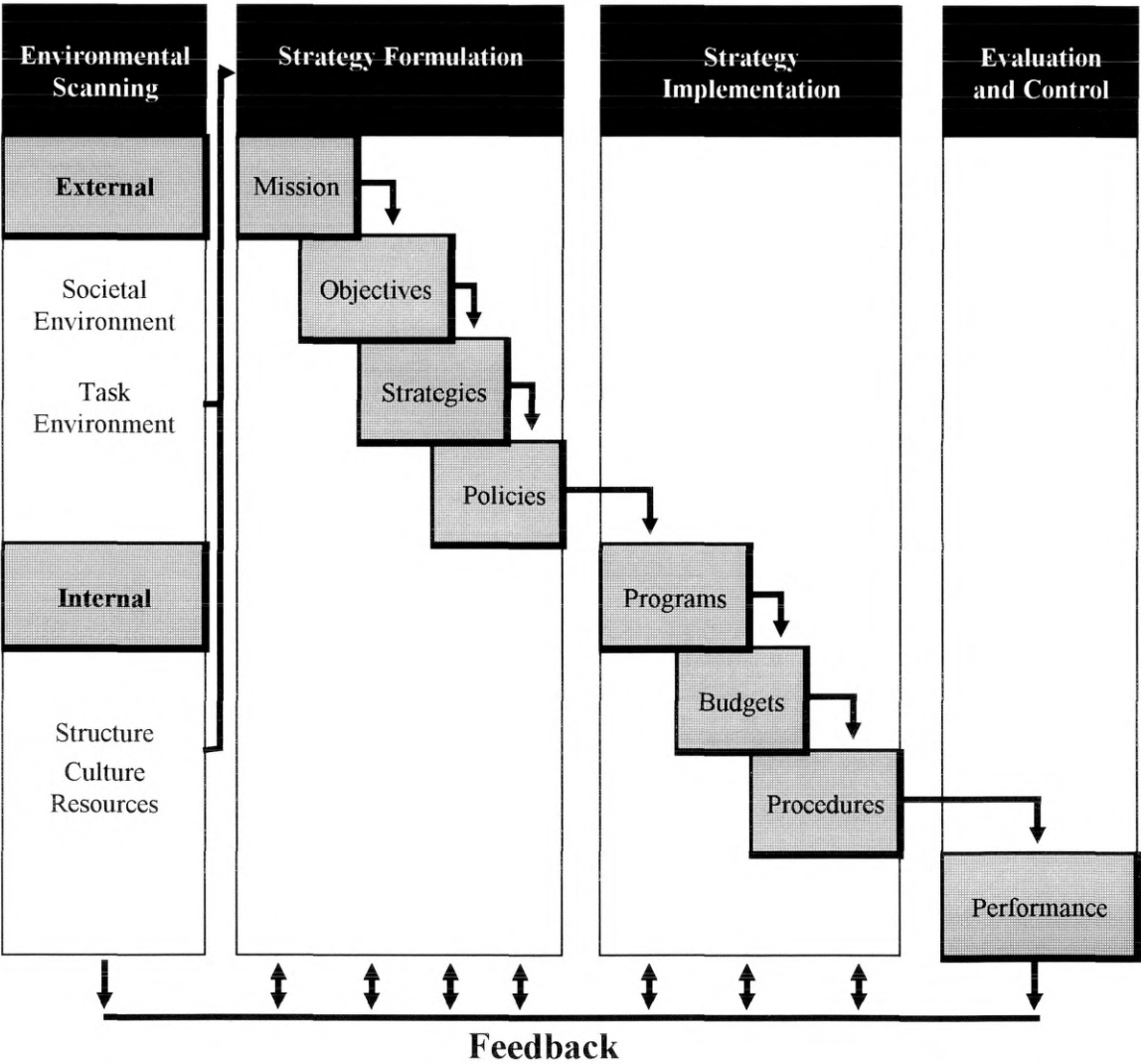
The questionnaire was based upon a development of the ‘Strategic Management Model’ presented in Wheelen and Hunger (1995, p.360). Being a highly structured model, this allows us to examine which parts of the strategic planning process are followed by micro firms, and to identify the areas in which they fall down. Figure 3.2 reproduces this model, showing the four main headings into which the questionnaire was to be split: Environmental Scanning, Strategy Formulation, Strategy Implementation, and Evaluation and Control. Beneath each heading can be seen the sub-headings which were to become separate categories in the questionnaire. Table 3.5 summarises the semi-structured questionnaire, and the full version, as used during the fieldwork, is reproduced in Appendix III.

### *Environmental Scanning*

The first heading, therefore, is ‘Environmental Scanning’, which involves an

**MODEL ON WHICH  
SEMI-STRUCTURED QUESTIONNAIRE WAS BASED**

**Figure 3.2**



Source: 'Strategic Management Model' in Wheelen, T.L. and J.D. Hunger (1995, p.360) *Strategic Management and Business Policy*

# SUMMARY OF SEMI-STRUCTURED QUESTIONNAIRE ON BUSINESS STRATEGY

**Table 3.5**

## **I Environmental Scanning**

*Analysis of internal and external factors affecting the business*

- line of business; resources, set-up costs, experience
- market; quality, price, location
- external relationship; suppliers, customers
- capitalising on strengths and exploiting opportunities
- improving weaknesses and combating threats

## **II Strategy Formulation**

*Mission, Objectives, Strategies, Policies*

- direction and goals of the business
- use (or not) of business plan
- definition of growth
- actions taken to achieve goals
- development and communication of long-term plans
- protection of business from rivals and substitutes
- attracting customers from competitors
- development of alternatives strategies
- importance and use of information technology
- enhancing and maintaining quality
- assuring customers of 'fitness for purpose' of product
- motivating employees

## **III Strategy Implementation**

*Programmes, Budgets, Procedures*

- actions taken to help achieve goals; investment, new products, staff
- use of customer feedback in improving quality
- problems in implementing strategies
- speed of implementation of new strategies
- constraints on growth of business
- financing growth
- cost cutting versus increasing sales
- financial restructuring
- budgetary procedures
- external sources of advice; accountants, auditors, bank managers
- usefulness of local or central government grants
- communication and implementation of new plans
- changing role of the owner-manager

## **IV Evaluation and Control**

*Performance*

- measures of assessing new strategies; profitability, budget versus actual
- methods of assessment; milestones, appraisals, targets
- policies changed because of performance appraisal
- what gives business the edge over rivals

analysis of both internal and external factors affecting the business. Wheelen and Hunger (1995, p.368) argue that “environmental scanning in small businesses is much less complicated than in large corporations”, and that “top managers, especially if they are the founders, tend to believe that they know the business and can follow it better than anyone else”. To test this assumption, therefore, the respondent was asked specifically why they had chosen to enter his particular line of business, being prompted on such things as their existing skills, personal assets, areas of expertise, experience, set-up costs, resource accessibility, a new product idea or a new niche or gap in the market that they had identified.

With one aim of the semi-structured interviews being to link the results to those of the administered questionnaire, some questions were incorporated to probe deeper into the reasoning behind answers previously given. The first of these asked why the owner-manager had chosen their particular market area, previously identified in the administered questionnaire from a list that included the local, regional, Scottish, British and international market. Respondents were prompted to answer with reference to any market research carried out on potential customers or competitors already in the market-place. Also with reference to the target market, respondents were questioned about the level of price and quality they had decided to offer, and whether this was chosen because of the products of existing rivals and the price and quality they were currently offering [*cf.* Hay *et al* (1993)].

External contacts of the owner-manager were thought to offer potential benefits to the entrepreneur who could take advantage of them. Curran (1996), for example, reports upon evidence that owner-managers of small firms used “the personalisation of relations with customers [as] a calculative strategy to reduce the influence of market factors such as differences in price, delivery and quality offered

by other firms” [cf. Bhidé (1994)]. The semi-structured questionnaire examines this finding, by asking respondents to describe their firm’s relationship both with its suppliers and with its customers; the former defined by reference to delivery, timing, quality, discounts, reliability, favouritism and regular suppliers; and the latter by repeat orders, customer loyalty, complaints and the actual number of customers the firm had on its books.

Finally, under the heading of ‘Environmental Scanning’, respondents were asked effectively to perform a SWOT analysis<sup>22</sup> on their firm; a discussion of its strengths, weaknesses, opportunities and threats [cf. Johnson & Scholes (1984)]. These were already known from previous interviews, but the respondent was asked now to clarify or explain further the reasoning behind their choices, and what each meant to their business; how do they capitalise on, or exploit their strengths; how do they take advantage of opportunities on offer; how do they try to improve upon weaknesses; and how do they combat existing or potential threats?

### *Strategy Formulation*

The second heading of the semi-structured questionnaire, as suggested by the model, is that of ‘Strategy Formulation’. It can be further sub-divided into the categories of Mission, Objectives, Strategies and Policies. The first, ‘Mission’, asks ‘What does the business stand for?’ [cf. David (1989)]. Respondents were asked, specifically, to identify the mission of their business, in terms of directions and goals, and also what the business stood for. They were then asked either how they used their business plan to help in the running of the firm, in order to achieve

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<sup>22</sup>Considered by some to be an extremely important factor in small business success. See, for example, Wheelen and Hunger (1995, p.369).

the mission. If the firm had no plan, respondents were asked how they knew or decided where their business was heading.

The section on 'Objectives' probed further into what the owner-manager hoped to achieve through running their business [*cf.* Aram and Cowen (1990)]. As nearly all respondents had previously expressed the hope or wish to grow the firm, the respondent was asked what they meant or understood by growth. In other words, what was growth with respect to their business; was it measured by an increase in employees, output, profits, sales, market share, product range or turnover? The respondent was then asked why they wanted to achieve their goals [*cf.* Thurston (1983)], both of growth and whatever else they had previously identified as being a major ambition. The object of this line of questioning was to discover whether the aims of the business were for personal or purely business reasons.

The next section looked in detail at the strategies used by the small firm; how did it aim to reach its objectives and what was it doing to beat the competition? Respondents were first questioned on how long-term plans were developed [*cf.* Baker *et al* (1993)]. For example, were project teams or formal meetings an aspect of the firm's operations, or did plans come about through informal discussions and consulting employees? What kind of information were long-term decisions based upon; was it 'hard' information, such as accounts, financial or business performance, or projected cash flow; or was it on 'soft' information, like hearsay, gossip or conversations with contacts?

The respondent was asked whether they would consider a so-called 'menu' of strategic options [*cf.* Johnson & Scholes (1984)]. In other words, did they generate a list of possible alternative courses of action? If so, how did they choose between these different ideas? Did they evaluate options by decision analysis using

computer packages [*cf.* Bhidé (1994)], or through advice from consultants; or was it through less formal information gathered from networking? [*cf.* Mintzberg (1994)].

The gaining and retaining of customers was investigated by reference to specific actions taken by the entrepreneur. First, they were asked what they did to protect their business from the threat of new or existing competitors, or alternative or substitute products. Did the respondent, for example, use trade intelligence, feedback or other information to protect their market; did they block threats or pose counter-threats; did they perhaps bargain over market segments or become involved in any horse-trading with competitors? Then the owner-manager was asked about methods used to try and attract customers away from rivals. Did they use such tactics as special offers, marketing and other promotional material, or did they rely on some technological advantage as being a draw to new customers? [*cf.* Porter & Millar (1991)].

With the speed of change of information technology, it was considered that the successful implementation of new technologies in the business might confer some competitive advantage upon the firm. It was already known from previous interviews how the respondent rated the importance of information technology to their business, on the scale of 'scarcely', 'moderately' or 'very' important. They were now asked, therefore, why they had rated it as they did. Did they think it was important because of the flexibility and adaptability it facilitated, because of the speed of communication it enabled, or because of the instant access it could give to news or other trade intelligence. The respondent was next asked in what ways information technology was implemented, for example, in budgeting, cash flow



forecasting, accounting, stock control, or for communications and information retrieval [*cf.* Dodgson & Rothwell (1989)].

The investigation of the 'Policies' followed by the small firms in the study involves an analysis of what ground rules are being followed to make sure the job is done correctly. First, the owner-manager is asked about the maintaining and enhancing of the quality of their product. Do they have regular spot checks or an approved TQM (Total Quality Management) system [*cf.* Hanks (1993a)], is their firm registered as BS (British Standard) or ISO (the international equivalent) approved, or do they have their own systems?

Owner-managers were next questioned about the kind of assurances given to potential customers about the 'fitness for purpose' or the quality of their product or service? How do they ensure the customers that their goods will be suitable for the customer's intentions? For example, they might offer guarantees, warranties or written assurance of the quality. Or, depending on the industry in which they operate, respondents might find that the provision of an after-care service is reassurance enough to potential customers.

Finally, in this section on 'Policies', respondents were asked to explain how employees were motivated to assist in helping to achieve the firm's mission. They were prompted on such issues as efficiency bonuses, staff participation or involvement in decision-making, prospects for promotion, the power and status they were awarded, and various other fringe benefits that might be used to elicit their cooperation [*cf.* Johnson & Scholes (1984)].

### *Strategy Implementation*

The third section of the semi-structured questionnaire examined the methods used by the small firm to implement the strategies they had developed. First, it looked at the 'Programmes' they were following; how did the respondent organise their operation to get what they wanted done as quickly as possible, and with the highest quality possible? First, then, the owner-manager was asked directly what they were doing to help achieve their goals. For example, were they bringing on-line new products, investing further capital or taking on more staff? [*cf.* Shuman & Seeger (1986)].

The next question asked about feedback from customers. The administered questionnaire had already provided the answer as to whether or not the respondent asked for feedback. Now, they were asked first, if they did receive feedback, how did they use it to improve their product or service [*cf.* Thurston (1983)], perhaps formalising it, and modifying systems, methods, processes or products because of it. If they did *not* receive feedback, how could they be sure that the customer was or was not satisfied with their product or service, and how would they know what needed to be improved?

The questionnaire next asked if the respondent had ever encountered any problems in trying to implement new strategies, and to describe such problems and how they were dealt with. Here, they were prompted on things like goal conflict, his adaptability and flexibility, re-focusing the business and re-positioning the firm in the market place. It was thought that speed might be important in implementing new strategies, so they were asked what would determine the speed at which they implemented new courses of action; was it, in fact, important to his business, were

costs or the time required to communicate new plans a constraint, and were they affected by rivals' actions or market trends?

Finally, under 'Programmes', the respondent was asked to identify anything that they thought was currently constraining the further growth of their business. Again, given prompts, they were asked of the relevance of financial constraints [*cf.* Reid (1996b)] and government policy in growing the firm. Then, where relevant, they were prompted to discuss the possibilities that training courses or further learning might enhance their, and their staff's, ability to grow the business, and asked what they thought might help them to overcome the constraints they had identified.

The next section under 'Strategy Implementation' was that of 'Budgets'; how much was implementation going to cost the business, and where did it intend to get the cash? The respondent was asked directly, then, how they would finance the growth they expected to occur. Would it be through reinvested profits [*cf.* Bhidé (1994)], through extra debt [*cf.* Woods *et al* (1995)] or additional equity? Then, they were asked to choose the most important issue to them at the moment, between controlling costs [*cf.* Porter (1980, 1985)], and generating revenue by extra sales.

The owner-manager was next questioned about the changing financial structure in the firm, as it grew [*cf.* Harris (1993); Hawkins (1993)]. For example, had there been much change in the debt/equity, or gearing, ratio; had the business managed to attract investment from outside backers; or had bank loans been paid off, or become a larger part of the firm's financing?

Next, they were asked to identify the principal components of their budgetary procedures; in other words, to say whether the business used profit and loss

accounts, balance sheets and other financial reports [*cf.* Welsh and White (1981)], or a more short-term based monitoring of things like cash flow, or debtors and creditors invoices. Did it, in fact, use any budgeting at all? [*cf.* Thurston (1983)]. How important, it was wondered, were the roles played by accountants, auditors, bank managers or any other small business advisors [*cf.* Fass & Scothorne (1990)], when it came to preparing budgets; did they assist by having oversight of plans, by preparing feasibility studies, or did they give advice on investment? And finally, as regards budgets and financial concerns, had local or central government subsidies or grants influenced the firm's budgetary procedures in any way; had the firm received grants for equipment, premises, advertising or staff, and had these played an important part in the decision to go ahead with plans?

The final section under 'Strategy Implementation' is that of 'Procedures'. This is related to the detail required to ensure that everybody knows what to do [*cf.* Johnson & Scholes (1984)]. The respondent was first asked, therefore, how new plans were communicated and implemented. They were prompted, in their replies, to make reference to any such policy books, leaflets and plans of action that the firm might use [*cf.* Ansoff (1965)]. How did they get employees involved and motivated to assist in the firm's mission, and how were the plans communicated; was it verbal, through conversation [*cf.* Mintzberg (1979)], or were they written down? Perhaps resources had needed to be re-allocated to implement a plan. Were employees party to any system of reward or bonus schemes, and was the employment of new full or part-time staff more important than sub-contracting labour elsewhere?

Then the respondent was asked to describe the changes, if any, that they had experienced in their own role since starting-up the business. For example, had

their authority now been delegated to subordinates; was the decision-making now, to some extent, out of their hands; had they changed the time allocated to various factors of the business; and had they experienced a move from the shop-floor level of production, to a more senior and managerial role?

### *Evaluation and Controls*

This final section of the questionnaire examined how, once plans had been developed and implemented, the management would evaluate the performance of these strategies, and control for any deviations from target; what were those few key things that would determine whether or not the business would make it, and how did it keep track of them? [*cf.* Thurston (1983)]. First, then, the respondent was asked how they described the success, or failure, of new strategies. For example, would it be through increased productivity as measured by, perhaps, a rising output/labour ratio; would it be through increased profits, more orders, an increased market share or asset growth; would the firm set targets and measure actual performance against these targets [*cf.* Johnson & Scholes (1984)]; or would success be evaluated in terms of the lifestyle goals of the owner-manager?

If the firm had some method of evaluating the success of strategies, which methods did it then use to evaluate these? So, for example, the respondent was prompted to refer to any use of milestones, personal performance appraisals [*cf.* Baker *et al* (1993)], check-lists of tasks requested and completed; as well as to more formalised methods of appraising performance, such as computerised targets or variance analysis.

The respondent was then asked about their attitude to changing policies, given their appraisal of performance. This question was meant to discover whether or

not they were willing to accept that some things just would not work, and that they should change tack if they realised this was the case. They were prompted, therefore, on methods of negotiating change and re-focusing the business, the redeployment of personnel, and whether they had needed to downsize, or to upscale their operations because of their performance appraisal.

Finally, the owner-manager was asked to identify the main item or items that singled their firm out from all others in the market; what did they have that gave them the edge over their rivals? In other words, what gave the firm a competitive advantage? Here, they were prompted, where necessary, to respond on their product quality and range, on the personal service they offered, on the after-sales care the business provided, and on the value for money or the competitive price that they thought the business gave.

### **3.6 The Semi-Structured Interviews**

#### *Sampling Frame*

During the course of the first year's administered questionnaire interviews, respondents were asked whether they would be willing to take part at a later date in an additional semi-structured interview, about their business strategy. The rate of agreement was high, so there was no concern about getting enough respondents. The target was to complete up to twenty such interviews. In the event, seventeen were concluded, but the information they provided were thought to be sufficient for the purposes of this study.

The aim was to develop detailed case studies for the firm's interviewed, and to group these under the categories of 'High', 'Medium' and 'Low' performers. This grouping was carried out, by cluster analysis [*cf.* Chapter 4, p.145] after few of the

semi-structured interviews had taken place, so the investigator was then able to target specific firms which fell in each of the performance categories, in order to ensure that the sample covered firms from each of the performance groups.

There were few conditions put on the firms chosen for interview. It was important that they had provided data for the first two years of the study, and that the investigator had met with the firms on at least one occasion previously, so that she knew the owner-manager and would be able to elicit the required information; personal contact and the development of a trusting relationship was important in the study. The owner-manager had to have agreed to the additional interview at an earlier point; there was the issue of 'keeping faith' with respondents, and not putting them off taking part in the larger study, which still required an additional two interviews. And finally, there had to be a good representation of firms from each of the three performance groups.

Before going to meet these firms for the next administered questionnaire, the investigator would therefore check that the firm met all of the above criteria. If it did, she would request the additional semi-structured interview, and make an appointment there and then for the meeting. If the firm did not meet the criteria, or the respondent was now unwilling or unable to take part in a further interview, then he or she was not pressurised to take part. Having agreed to the meeting, the respondent was sent a preletter, outlining the reasons for this additional study, and an agenda for the interview. Thank you letters also formed part of the protocol, as for the administered questionnaire interviews.

Between the months of March and December 1996, therefore, the seventeen semi-structured interviews were conducted. In the end, there were three from the high performance (the smallest) group, six from amongst the medium performers

(also the medium group by number of firms), and eight from the low performers (the largest group in the sample). The data generated from these questionnaires were developed into written case studies, which are included in Appendix IV to this work, and which form the basis for the analysis in Chapters 5 and 6.

### **3.7 Summary**

Chapter 3 has described the means by which a sample of 150 small firms in Scotland was selected for interview. The Directors of 18 Scottish Enterprise Trusts were shown to be of great assistance in this procedure, and conversations with them proved to be instrumental in the design of the administered questionnaire. An awareness of the role of the Enterprise Trusts was developed and a picture emerged of the climate in which new small firms in Scotland operate.

The methodology of the project was described and justified. Section 4 of the administered questionnaire, on Business Strategy, was analysed, section by section, relating questions to both the literature and comments made by the Enterprise Trust Directors. The reasons for which questions were included and the knowledge it was hoped to be gained from them was outlined.

The actual administration of the questionnaire was then discussed. It was shown how a pilot study of 14 firms helped to refine the questionnaire and establish its final form. The way in which the main study was carried out was then described, as were the methods used to gain and retain the cooperation of respondents. It was shown how a promise of confidentiality and feedback of results helped to elicit the continued participation of owner-managers of new small firms.

Following on from this, the development of a semi-structured questionnaire was discussed, along with the reasons behind wishing to do so. It was found that such



a questionnaire would enable the respondent to develop lines of thought established in previous interviews, and to explain and further illustrate the methods implemented in forming and implementing new strategies in his business. A number of detailed case studies were written, based on the fieldwork evidence thus gathered, and their usefulness in illustrating points raised from statistical and econometric analysis was observed.

# Chapter 4

## Database: construction and analysis

### 4.1 Introduction

Chapter 4 introduces the database used to store the information gathered from the administered questionnaire. It shows how *Paradox* was used to create a relational database which could grow as the study evolved, and from which data could be transferred easily between software packages for analysis. The data relevant to this study are held, primarily, in the Table, STRATEGY, but use is also made of other performance characteristics from the MARKET and FINANCE sections.

Section 4.3 discusses the summary statistics of all 150 firms in the study, comparing the data from years one and two. First, it presents some general characteristics, in terms of size by employment, number of products, target market, rivals, the manufactures/servicing split, and financial measures. It then takes the summary responses for each section of the administered questionnaire in turn, comparing results from years one with those in year two, to give an impression of the general tendencies amongst the sample as a whole.

In section 4.4, the firms are grouped into classes of high, medium and low performers, using a method called cluster analysis. This provides a convincing ranking of the 150 firms in the study, with a small group of high performers standing out well above the remaining low and medium performers. These clusters are to form the basis for the detailed analysis of strategies carried out in Chapters 5

and 6.

The general characteristics of firms in each cluster are discussed in section 4.5. this analysis looks at various measures of performance that have been used commonly to describe success or failure. It is found that these measures generally accord well with the rankings suggested by the cluster analysis. Subjective evaluations by the chief investigators, and reference to company information gathered during fieldwork, confirm the groupings. For the high performers, the values of the variables under consideration are clearly distinct from those for the other firms, in general, with only one or two discrepancies. Similarly, the low performers suggested by the clustering do worse, on average, by reference to these additional performance measures. It is with some confidence, therefore, that the clusters generated are used as the focus for the remainder of this work.

## **4.2 Database Construction**

The administered questionnaire as a whole generated an immense amount of data: there were some 500 quantitative variables, and an additional 50 or so qualitative variables; 150 firms were to be investigated; and the main study was to include four interviews with each firm still in business. It was therefore important to choose the correct software on which to store this valuable data. It had to have the facility to grow as the study grew, to incorporate quantitative as well as qualitative responses, and to allow data export to other packages for statistical and econometric analysis. In addition, it had to allow the investigator to pick out specific information from any part of the questionnaire, for any firm, in any given year or years.

Spreadsheets were therefore ruled out as infeasible. Even if one could have been found that was large enough to hold all of the data acquired, the inflexibility of using such a device was a major drawback. Searching for the required data, screen by screen on the computer, would be just too time-consuming, and also likely to result in errors. The preferred method was a database management system, and the specific package chosen, *Borland Paradox for Windows Version 5.0*.

The advantages of using this system are several-fold. As it states in the introduction to the *User's Guide* [Borland (1994, p.1)], “the paradox of *Paradox* is that this sophisticated database program is powerful and fast, yet easy to learn and use. *Paradox* is designed for computer users with all levels of experience, from beginners to advanced. It gives you the power of a full-featured relational database without the need for programming”.<sup>1</sup> In a database, the data are stored in tables; each column of a table contains a different variable or ‘field’, and each row, a record. A ‘flat file’ system would enable the user to look at only one table at a time. The advantage of a database like *Paradox* is that it is a ‘relational’ database. In other words, it recognises that there is a relationship between the tables, and enables the user to extract the specific information he wants from a combination of tables.

The database was therefore divided into eight tables; the first for general information, such as the respondent’s name and address, the business’ name, the date of interview, and the person who had conducted the interview; and seven tables, each covering a separate section of the questionnaire. For this thesis,

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<sup>1</sup>See also Reid (1992a) for a detailed explanation of the advantages of using a relational database, with particular reference to a previous study on small firms.

therefore, the relevant data are held in the table entitled 'STRATEGY', and additional information on performance indicators such as turnover, for example, may be found in the 'MARKET' or 'FINANCE' tables.

In order to extract correctly the data from several tables at once, it is important to define one or more 'key' fields. These are fields which are identical in each table, and enable the database programme to identify and link related information. In this study, two key fields were named: the first, *Firmid*, denoted the firm's identification number, allocated during interview, and was a number between '001' and '150'; the second key field was *Yrstud*, which showed the year of the study in which the interview took place, and was a number between '1' and '4' (or '2', for the purposes of this study). Thus it was possible to extract, for example, variables from the 'STRATEGY' table relating to firms 001 to 150 in year 1, and compare this to performance indicators for those same firms taken from the 'FINANCE' table in year 2.

The data gathered were in one of four possible forms. First, there was the simple 'yes/no' response, where a 'tick' on the questionnaire would denote a positive response. Second, were the categorical variables, where the respondent was asked to choose from a list of options, for example, 'slightly, moderately or very'. Third, the reply was in numerical form, for example, number of months. And fourth, the respondent might have given a textual response. Each of these will now be discussed in turn.

In questions where the response could only be either positive or negative, for example, 'Do you have a business plan?', the variable was coded in binary [0,1] form. In other words, a positive response was coded as '1' on the database, and a negative response as '0'. Similarly, if the respondent were asked to choose

between two alternative responses, a '1' was used to indicate one response, a '0' the other. If, in the latter case, the question was irrelevant, this was then coded as '\*'. Where any answer was unknown and could not be estimated by the respondent, a '?' was used to signify such a response.

Several questions asked the respondent to estimate the degrees of intensity of some particular item, for example, whether they felt that competition posed a strong, medium or weak threat. These so-called categorical variables, where only one of a few possible categories is relevant, were coded on a sliding scale from, in the case just given, '3', through '2' to '1'. The number '3' therefore represented a very strong threat, and the number '1', only a weak threat.

The third possible kind of response expected was in numeric form, for example, 'How long have you been ...'. Such answers were typically given in months or years. So long as responses were standardised, usually to months, given that the firms in question were so young, there was no problem. *Paradox* accepts many different forms of data entry, including numeric, date and alphanumeric, but allocating a variable the correct form was not usually difficult, and it could, in any case, be changed or modified at a later date.

Finally, there were some responses that could be input only as text. *Paradox* has so-called 'memo' fields for this purpose. When the table is called up on screen, only the number of characters, say the first 25, that are user-defined are visible. However, the operator is able to access this memo field, which opens up to reveal perhaps a whole page of text. This was more than adequate for the purposes of the study. Examples of possible text responses might come from the question, 'What is your main line of business?'. More frequently, they might provide additional examples to the given options. For example, if the given possible

reasons for starting the business did not adequately describe the respondent's own reason, then his answer to that question would be entered into an additional memo field.

*Paradox* also has the facility to limit the data input to specified responses, which in turn helps to maintain the accuracy of the data. For example, where a response can be only either '1' or '0', the user can set up the database to accept only one of these two numbers. Similarly, if a range of variable entries must total 100%, again *Paradox* can be programmed to alert the user to incorrect entries. From the discussion above, it is clear, therefore, that it is vitally important that the database be set up carefully, before data entry can even begin.

With so many variables and different coding options, it is obviously important to keep an accurate record of these. To this end, a data dictionary was produced. This gives a complete listing of every variable name, a brief description, the table in which it is to be found, and reference to a 'note', which defines how responses to that variable are coded. Appendix I gives the information thus produced for the 'STRATEGY' database table. Field names were limited to a maximum of eight characters, in keeping with the limited length of variable names permitted in the software used for analysis.

To present a clearer explanation of how the database was set up, Figure 4.1 shows an extract from the top, left-hand side of the 'STRATEGY' table. The format of menus and toolbars along the top of the screen will be familiar to anyone who has used a Windows operating system. There are the usual 'print', 'cut', 'copy' and 'paste' commands, as in any good word processor. The icon that includes a spanner (*viz.* fifth from the left) allows the user to 'reconstruct' the table, adding new variables or modifying the existing fields, then there are various

# EXTRACT FROM PARADOX DATABASE

## ‘STRATEGY’ TABLE

Figure 4.1

Paradox for Windows - [Table : STRATEGY.DB]										
File Edit View Table Record Properties Tools Window Help										
STRATEGY	Firmid	Yrstud	Busplan	Formwrit	Whoplana	Whoplanb	Whoplanc	Whopland	Whoplan	
1	001	1	1	0	1	0	1	1	0	Accou
2	001	2	*	*	*	*	*	*	*	
3	002	1	1	0	1	0	1	0	0	Self pl
4	002	2	1	0	1	0	1	0	0	
5	003	1	1	0	1	1	0	0	0	
6	003	2	1	0	1	0	0	1	0	
7	004	1	0	*	*	*	*	*	*	
8	004	2	0	*	*	*	*	*	*	
9	005	1	0	*	*	*	*	*	*	
10	005	2	0	*	*	*	*	*	*	Plan d
11	006	1	1	1	*	*	*	*	*	
12	006	2	*	*	*	*	*	*	*	
13	007	1	1	1	1	0	0	1	0	South
14	007	2	*	*	*	*	*	*	*	
15	008	1	1	1	*	*	*	*	*	
16	008	2	1	1	*	*	*	*	*	
17	009	1	1	0	1	0	0	0	0	
18	009	2	1	1	1	0	0	0	0	
19	010	1	1	0	1	1	0	1	0	
20	010	2	*	*	*	*	*	*	*	



database tools allowing the user to 'search' or 'filter' the data. The directional arrows in the middle, at the top of the screen, allow the user to scroll through the records, one or a page at a time, or to go straight to the last (or back to the first) record immediately. On the right are tools for constructing 'forms', and providing specialised layouts, as well as the obligatory 'help' and 'tutorial' buttons.

And so to the table itself, whose name is given in the top left of the screen. Along the top of the table are given the field names, translated to variable names in the later analyses. The two key fields (*viz.* *Firmid* and *Yrstud*) are on the left, followed by the binary variables, *Busplan* ('do you have a business plan?'), and *Formwrit* ('is it a formal and written plan, or is it in your head?'). The following five variables enquire into who was involved in preparing the firm's business plan; a '1' signifying that the particular option was relevant, and a '0' that it was not. And finally, just to the right of the screen can be seen the edge of the memo field, *Whoplan*, which gives textual replies to the question 'who was involved in preparing the plan?'. Down the left of the screen, under 'STRATEGY', *Paradox* numbers the records automatically. Careful observation shows that this table contains data for firms over the first two years of the study, and that firm 9, for example, had formulated a written business plan since his first interview in year one, where the plan was only 'in his head'.

Data are selected from a database by means of a 'query'. 'Structured Query Language', or SQL, is one method of doing so, and is commonly used by older database packages, or those that do not run under *Windows*. However, its use involves some computer programming and therefore requires more detailed computer knowledge, and also more time. *Paradox* can be queried using SQL, which is a useful facility when needed, particularly for complicated queries; but an

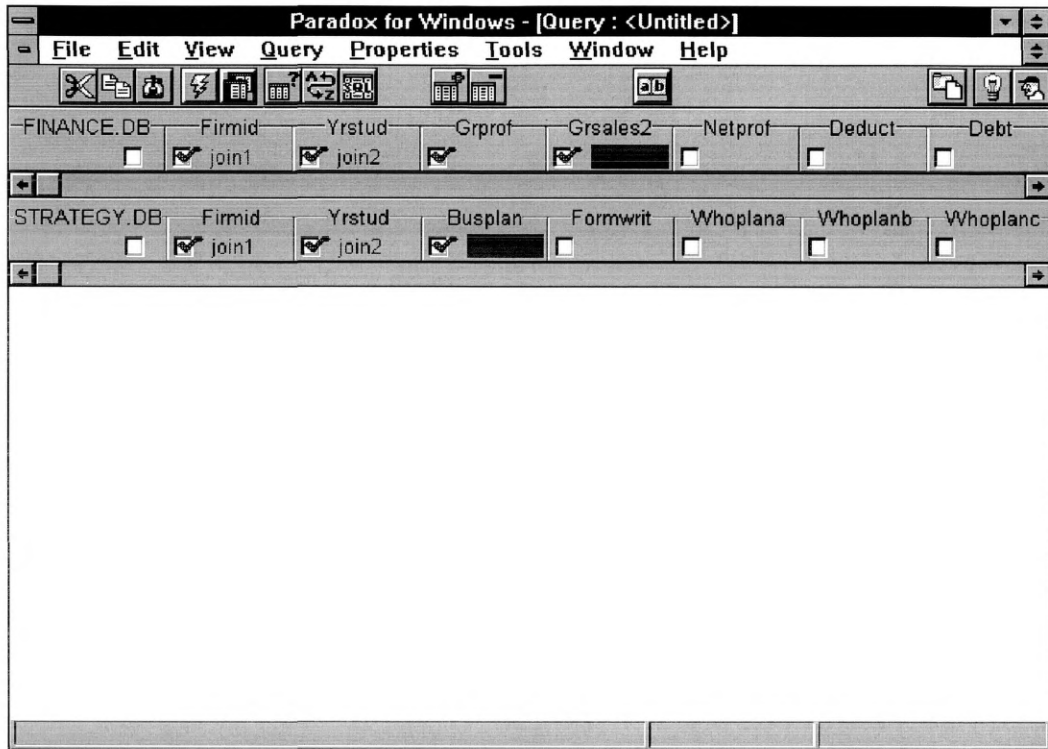
easier was of doing this is by using its ‘Query By Example’, or QBE, function. Basically, the user provides an example of the query he wishes to perform, and *Paradox* applies this to the relevant data.

Figure 4.2 shows how a query might be set up under *Paradox*. The top screen shot shows the query, as defined by the user. The two tables to be queried are shown on the left by their names, with the attachment ‘.DB’ to denote a *Paradox* table. The links between tables are created by ‘joining’ the key fields in each table (cf. *Join1*, *Join2*). Each field that contains a ☒ has been selected by the user for display. To the right of these ‘ticked’ boxes, there is space for the user to modify the query, or to request only specified data. For example, in the *Busplan* field, the user could put ‘1’ to receive data only from firms who had business plan. Alternatively, a ‘0’ would provide data entry from firms who had no plan. Likewise, under *Grprof*, the user could define limits to receive, for example, only data relating to firms with gross profits between £100,000 and £150,000. To run the query, the user need only ‘click’ with a mouse on the fourth icon from the left, and *Paradox* will perform the data search.

The resulting answer table is displayed in the screen shot below the query in Figure 4.2, and its meaning is fairly self-evident. The table name, ‘ANSWER’, is, as always, to the top left. Under *Firmid*, each firm is listed twice, as two years worth of data are given per firm. Then are given the gross profit and turnover figures per firm, per year. *Firmid* and *Yrstud* are repeated, as they now relate to the second table from which data have been queried, and finally, the results are given from *Busplan*. The table as it stands is now ready for export, but it can be reconstructed beforehand if the user so wishes. For example, it might be useful to

## EXAMPLE OF PARADOX QUERY FROM 'STRATEGY' AND 'FINANCE' TABLES

Figure 4.2



Paradox for Windows - [Table : :PRIV:ANSWER.DB]								
File Edit View Table Record Properties Tools Window Help								
ANSWER	Firmid	Yrstud	Grprof	Grsales2	Firmid_1	Yrstud_1	Busplan	
1	001	1	50,000.00	500,000.00	001	1	1	
2	001	2			001	2	*	
3	002	1	94,000.00	299,000.00	002	1	1	
4	002	2	145,000.00	528,750.00	002	2	1	
5	003	1	96,782.00	133,974.00	003	1	1	
6	003	2	130,000.00	214,000.00	003	2	1	
7	004	1	90,000.00	170,000.00	004	1	0	
8	004	2	80,000.00	250,000.00	004	2	0	
9	005	1	46,000.00	70,000.00	005	1	0	
10	005	2	24,000.00	80,000.00	005	2	0	
11	006	1	15,000.00	25,000.00	006	1	1	
12	006	2			006	2	*	
13	007	1	35,000.00	73,000.00	007	1	1	
14	007	2			007	2	*	
15	008	1	60,000.00	310,000.00	008	1	1	
16	008	2	202,000.00	340,000.00	008	2	1	
17	009	1	60,000.00	200,000.00	009	1	1	
18	009	2	113,000.00	400,000.00	009	2	1	
19	010	1	230,000.00	1,000,000.00	010	1	1	
20	010	2	250,000.00	1,200,000.00	010	2	*	

Record 1 of 300

sort the data into two groups, by whether or not they have a business plan, or by year. *Paradox* can deal with this quite simply.

Once the table is in a form acceptable to the user, and to the software package to which it is being exported, the task is performed quickly and easily. Typically, the data were exported to *Microsoft Excel* spreadsheet files, where they were then saved. In this format, the data could be read easily by several programmes, including the econometric package, *Shazam*, and the *Statistical Package for the Social Sciences*, better known as *SPSS*.

This section has shown how a new database was set up using primary source fieldwork-collected data. It has explained why the *Paradox* database was chosen for this task, and detailed the advantages of using such a system. These include facility, clarity and speed of operation. The following section now discusses the results obtained from years one and two of the study, as generated by the methods described above.

### **4.3 Statistical Analysis**

The average results for each of the two years of the study have been inserted onto the administered questionnaire, and are contained in Appendix II. The results from year one are given to the left, and those from year two to the right, and are distinguished by their typeface, as explained in the *Notes to Appendix II*. Discussion of the results from the *Business Strategy* section of the Administered Questionnaire will appeal to the data contained in Appendix II.

First, though, a brief discussion of the sample in general is in order. Table 4.1 shows the main characteristics of firms from years one and two. 150 firms were interviewed in year one of the study, with an average age of 21 months, and six

## MAIN CHARACTERISTICS OF FIRMS IN YEARS 1 AND 2

Table 4.1

	Mean Values: Year 1 n=150	Mean Values: Year 2 n=122
<b><i>Business Age and Employees</i></b>		
<i>Time in business</i>	21 months	33 months
<i>Directors</i>	1	1
<i>Managers</i>	0	0
<i>Full-timers</i>	3	3
<i>Part-timers</i>	2	4
<i>Trainees</i>	0	0
<i>Total employees</i>	6	8
<b><i>Market Characteristics</i></b>		
<i>Product groups</i>	4	4
<i>Products</i>	48	33
<i>Main market</i>	local (34%)	local (40%)
<i>Major rivals</i>	11	7
<i>Minor rivals</i>	24	26
<i>Manufactures</i> <sup>1</sup>	36%	35%
<i>Servicing</i> <sup>2</sup>	64%	65%
<b><i>Financial Measures</i></b>		
<i>Turnover</i>	£233,510	£233,600
<i>Gross Profits</i>	£49,860	£66,994
<i>Net Profits</i>	£14,705	£14,504

*Notes:*

<sup>1</sup> Standard Industrial Classification (SIC) <50

<sup>2</sup> Standard Industrial Classification (SIC) ≥ 50

total employees, including the owner-manager. By the second year of the study, 122 were still in business, average age was 33 months, and total employees had increased by two part-time workers to number eight altogether. Given that the majority of firms were very close to inception at the first interview, a relatively high failure rate had been expected by the second year, so the 'deaths' of 28 firms (19%) was not totally unexpected.

The number of product groups or categories<sup>2</sup> into which each firm could divide their total products was consistent, at four each year; but the number of individual products had dropped from an average of 48 to 33. This effect might be due either to firms in general narrowing their product range; or by firms with a large number of products in year one failing, and dropping out of the sample by year two. The most popular market area targeted was the same in both years, being the local market. The number of major rivals with whom firms thought they competed directly fell from 11 to seven, whereas the number of minor, or all other, rivals was fairly steady, in the mid-twenties. Taking the firm's SIC (Standard Industrial Classification) number, at the two-digit level, as an indication of whether it falls under the 'manufacturing' or 'service' industries heading, there is a slight drop shown in the level of manufacturing firms, from 36% in year one to 35% in year two, although this difference is not significant.

In terms of financial measures, average annual sales, or turnover, were remarkably similar in each year, at around £233,000. Net profits were equally close, at just under £15,000 in year one, falling slightly by the second year of

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<sup>2</sup> For example, toasters and hairdryers would be two product groups; four *kinds* of toasters and three *kinds* of hairdryers would be seven individual products.

interviews.<sup>3</sup> The most interesting difference is in the gross profits figure; just under £50,000 in year one, but rising to almost £67,000 in year two. It seems surprising that, with turnover and net profits hardly changed, there should be such an increase in gross profits. In fact, the average gross profit margin ( $\text{Gross Profit} \div \text{Turnover} \times 100\%$ ) grew from 21% to 29%, while the average net profit margin ( $\text{Net Profit} \div \text{Turnover} \times 100\%$ ) is constant at 6% per annum.

One might expect an improvement in the gross profit margin to lead in turn to an improvement in the net profit margin, but this is not the case here. For gross profit to be so much higher relative to turnover, the average cost of sales must have decreased.<sup>4</sup> This might be because of the failure of more manufacturing firms than service firms in the sample; their cost of sales, which includes direct labour and raw materials, is likely to be much higher than that of a business in the service industry, so their exclusion from the sample will lower the average cost of sales. However, it seems more likely to be due to the fact that expenses must have risen substantially from one year to the next; which perhaps can be explained by the noted increase in average employment by two part-time workers, whose wages might be deducted under the heading of ‘other expenses’ (for example, if they were occasional or sub-contracted workers), *after* gross profit has been calculated.

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<sup>3</sup>See Reid (1996a), who finds that firms in the same sample who continue to trade from one year to the next have a negative net profitability (measured as  $\text{Net Profits} \div \text{Net Fixed Assets}$ ), compared with those who cease trading, whose net profitability is positive. He suggests that one explanation for this is that the firms who continue to trade pay significantly higher wage rates than those who cease to trade.

<sup>4</sup>

<i>Profit &amp; Loss Account</i>	<u>£</u>
Turnover	X
Less: Cost of Sales	<u>(X)</u>
Gross Profit	X
Less: Other Expenses	<u>(X)</u>
Net Profit/(Loss)	<u>X/(X)</u>

However, it is difficult to make any firm conclusions along these lines, given that such small firms have different accounting techniques and adopt different reporting conventions, as there is no standard for organisations of their size.

The above discussion has served to describe the average firm in the sample, and key differences in these businesses between years one and two. It is shown that the firms are very small, 'micro' firms, and that they are fairly close to financial inception. They typically target a local niche market, and admit to having few (less than ten) major rivals. Sales are, on average, under £¼m, with little change between interviews. With this idea of the sample now in mind, Chapter 4 continues by presenting the results from an analysis of the business strategy section of the questionnaire.

### *Aims, Ambitions and Making Decisions*

In year one, the two most popular reasons for the respondent having started the business were that it was an alternative to unemployment (25%), and to satisfy their need for achievement (25%) [cf. Bamberger (1983)]. In the second year, the question was re-phrased slightly to ask why they were still running the business. By this stage, the need for achievement had become by far the most important reason (36%), with an alternative to unemployment and to 'get rich' being the next most important (17% each).

None had taken or handed over a family business, and very few were in it just to 'profit from a hobby' (3% in year two). A modest amount (from 18% to 13%) were most keen to be their own boss. Disappointingly few were trying to exploit a new market opportunity (11% in year one, falling to 9% in year 2). Some respondents suggested other reasons for starting the business, including: "I like



running things and enjoy running businesses”; “It’s my life now ... I know the industry”; “To provide a good livelihood and be financially worthwhile and interesting”; and “To come out of the rat race” [*cf.* Cooper (1993)].

When asked what was the main aim for the business, long term profit (30%) and general growth (20%) [*cf.* Lee (1994); Bhide (1994)] were most common choices in year one, followed by survival (16%). By the second year, these three were still regarded as being most important, although the degrees of importance had changed; long term profit was up to 38%, growth to 23%, and those who were seeking mainly to ‘survive’ had dropped to 13%, reflecting the greater confidence that comes with experience [*cf.* Churchill and Lewis (1983)]. Many respondents commented that one aim would lead to another, or that they were aiming for several complementary goals<sup>5</sup>, but the three identified above accounted for 74% of all responses. Short term profit, increased sales, increased market share and a high rate of return were singled out by only a few as being the main aim of the business. Again, some alternative responses were given to this question, including: “To build a business I can sell”; “To keep money coming in”; “To pay off our debts”; and “To develop a sizeable organisation in small business terms, which can be sold at a reasonable profit in about 10 years time - a business that is fun and exciting, and that I can enjoy, but that is worth something”.

Respondents were asked if, when making decisions, they would consider the past experience of other, similar businesses. For strategic decisions, 56% said ‘yes’ in year one, rising to 67% in year two [*cf.* Hay *et al* (1993)]. For operational, or day

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<sup>5</sup> See Jarvis *et al* (1996, p.iii), who find that “the motivations of the owner managers of small businesses are often complex and they tend to have a range of business objectives”.

to day, decisions, the figures were slightly lower, at 54% in year one, and 60% in year two. They were then asked whether one single person had responsibility for each of these categories of decisions, or whether they came about through negotiation between more than one person. In year one, 55% said that strategic decisions were negotiated, falling to 53% in year two [*cf.* Miller and Toulouse (1986)]. Understandably, fewer (45%) would negotiate over operational decisions in year one, falling again to 41% by year two. There was little change in the underlying bases upon which decisions were made; over two-thirds of decisions in each time period were made for purely business or financial reasons, compared with under a third for personal reasons [*cf.* Wheelen and Hunger (1995)].

Respondents were asked whether they would seek outside advice when formulating new strategies, and if they would be willing to pay for this advice. In year one, outside advice was said to be sought on decisions about new investment (51%), legal matters (65%), insurance (89%) and accounting matters (86%). In-house capabilities were typically thought to suffice on matters of marketing (62%), personnel (77%), research and development (74%) and new product design (78%). By year two, the same four matters would require outside advice, and three of these had increased in importance. Outside advice on new investment would now be sought by 73% of respondents, legal matters by 94%, insurance by 72% and accounting matters by 91%. There was little change in the percentages who would carry out marketing, personnel, research and development and new product design entirely in-house. For the older companies, therefore, it seems that growth and experience has led to an increased awareness of the need to call in professionals for important decisions, particularly on new investment (up 22%) and legal matters (up

29%) [*cf.* Peiser and Wooten (1983); Johnson and Devins (1994)].

In terms of a willingness to pay for the outside advice received, in year one, respondents thought that help on new product design (61%), legal matters (84%), insurance (76%) and accounting matters (88%) would be worth the investment. By year two, legal and accounting matters were still thought to be things that warranted payment, but advice on insurance was much less likely to be paid for (down 33%), as was advice on new product design (down 39%). This can perhaps be explained by the fact that product design and insurance are associated with start-up firms. Once they are in place, there is no further need for advice; firms might be willing to pay for help on product design in the early stages, to assist them in becoming established, but the evidence is that this becomes less important as they grow in age and experience.

Legal and accounting matters, however, are on-going concerns and, in general, a small firm does not have the specialisation required to carry out these functions in-house [*cf.* Hofer and Sandberg (1987)]. To conform to statutory requirements it is, therefore, obligatory to pay the relevant specialists to carry out such tasks. Very few respondents mentioned the advice, both legal and financial, that was available to them free through the various agencies set up to help small firms; but even if they were aware of its existence, they rarely seemed to use the facilities on offer. It is interesting to notice too that, by the second year of interviews, respondents were more likely to pay for advice on marketing (up 11%) and personnel matters (up 23%) than previously. This reflects the increase in employees (*viz.* two extra part-timers) and their wish in general for growth, as discussed above.

### *Forward Planning*

In year one, 89% of respondents admitted to having a business plan which was typically (79%) formal and written, as opposed to the 21% who had a visionary plan [*cf.* Mintzberg (1994)] simply held in their head. All respondents had been personally involved in the development of the plan, along with others in the business (25%) and outside help (68%), which often included an accountant, bank manager or enterprise trust agency.

By the second year, the number of respondents who still had a business plan had dropped to 64%, with a higher percentage (37%) claiming to hold the plan in their head. Outside help in formulating (or re-formulating) the plan had become much less important, with only 33% asking others to assist them in constructing their plan. There seems, therefore, to be a loss of interest in having a formal, written business plan, contrasting with the general enthusiasm near start-up. This may be explained in a couple of ways. First, there is evidence to suggest that some early-stage plans were only formulated to gain the start-up grants and allowances available to a small firm, or to obtain a bank loan; for example, as one respondent admitted, "I did it just to get the grant" [*cf.* Bhidé (1994)]. In other words, respondents were often only developing plans under the external pressure put upon them by funding bodies. Second, once the business is up and running, and the new business grants have dried up, the time and effort required to constantly revise, update and stick to plans may become too much for the owner manager of a new firm, who is very often a sole trader [*cf.* Churchill and Lewis (1983)].

However, those who did have plans reviewed them regularly, on average twice a year, and this remained unchanged at the time of each time of interview [*cf.* Baker *et al* (1993)]. The forward planning horizon of the firms in the sample was also

encouragingly long. When asked how far ahead respondents looked when evaluating the impact that decisions might have, the average response in year one was 15 months, rising to 19 months in year two. Some had even produced plans forecasting up to five years ahead [*cf.* Shuman and Seeger (1986)].

### *Funding Growth*

Funding the operations of a small enterprise is, more often than not, a major problem. In the first year of the study, 91% of respondents had invested their own savings in the business [*cf.* Churchill and Lewis (1983)], 73% had received a grant or subsidy, very often the *Enterprise Allowance* of £40 a week, and 49% had taken out a bank loan or were running on overdraft. By the second year, these were still the main sources of funding, although the importance of debt finance from the bank had risen to 67%. Family and/or friends had been moderately helpful in providing loan funding (15% in year one, 11% in year two), but only a few of them (3% by year two) held an equity stake in the business. A tiny proportion had gained venture capital backing (1% in year one, 2% in year two) or business angel support (1% in each year).

Respondents were questioned about preferred methods of improving their cash flow. When asked whether they would rather inject more capital or restructure the payback terms of debtors and creditors, 64% chose the former in year one, rising to 69% in year two. Of those who favoured the restructuring method, very few would opt for factoring (3% in year one, 0% in year two) or invoice discounting (3% in year one, 2% in year two) saying, for example, “I wouldn’t touch factoring with a barge pole” [*cf.* Harris (1993); Hawkins (1993)]. The most popular option was to extend their trade credit with suppliers (51% in year one, 46% in year two)

[*cf.* Bhide (1993)], or in other words, to give themselves longer to pay: for example, “we would put off paying invoices” or “put off the rent for a month” [*cf.* Reid (1996a)]. This option was followed by chasing up debtors more quickly (24% in year one, 34% in year two): again, examples given included “telling clients who are misbehaving that we can’t accept this any more” and “we’re going to go into direct debiting”.

Some provided fairly novel ways of improving their cash flow. For example, one, who wanted to make their bad debtors pay up, gave the following example: “We don’t go through the legal system. We use a company who uses the methods they feel fit to get the money, for example, intimidation”. Several though they would probably speak to the bank manager about extending their overdraft or taking out a loan, before resorting to using any of the methods mentioned above [*cf.* Welsh and White (1981)].

Just under a half (49%) of respondents would be willing to sacrifice a proportion of their equity stake in the business, if it were expected that this might lead to further growth [*cf.* Bull (1993); Bhide (1994)] . This figure had risen to 56% by the second year of interviews. In both periods, the majority wanted to retain a controlling share of the business (on average, 52% in each year). A much higher proportion (89% in each year) were willing to accept smaller profits to help business expansion. In other words, they were willing to forgo present benefits by investing in the business, if this would lead to long-term future financial gain; but were less happy about giving up a share of the ownership of the business to achieve the same result.

### *Information, Technology and Communications*

Almost all respondents received some form of feedback from their customers about the product or service they were providing. In year one, about a quarter (23%) received information simply by asking for it, just under a third (30%) said it was given freely, and almost a half (48%) said it came from a combination of requested and voluntary information. By the second year, fewer (19%) were leaving things to chance by expecting feedback to be given without prompting. It was now asked for by 18%, and was both volunteered and requested for 63% of firms. Respondents were therefore showing an increasing tendency to ask for feedback to ensure that their product was of a good enough quality, and if it were not, to find out why.

Reactions to customers' comments changed only slightly from one year to the next. Note would be taken of them (84% in year one, 83% in year two), for referral later, either mentally or, often, written down. respondents would discuss comments with other customers (60% in year one, 55% in year two) to find out if feelings were similar or widespread. The vast majority (86% in year one, 85% in year two) would implement changes based on the suggestions of customers, if this were required and deemed necessary. Very few (2% in year one, 3% in year two) would do nothing at all. Some respondents had quite sophisticated ways of getting and logging information: for example, one owner manger explained: "I have a form which every customer receives. I ask them to complete and return it, and investigate any bad point"; "I document it and feed it into the computer. Then I run a graph which gives peaks and troughs"; and "I keep record cards - everything you say and do has to be written down".

Two-thirds of respondents said that they actively sought to gather trade intelligence on their rivals in year one [*cf.* Hay *et al* (1993)], falling to 55% by year two, possibly because of the time involved in doing so. In the first year of the study, respondents were most likely to have an idea of their rivals' product quality (92%), customer relations (83%), new products (81%) and personnel (64%). They were less aware of the size of rivals' market share (39%) and financial performance (30%). By year two, they were still likely to know as much as they did before, but were becoming slightly more aware of rivals' financial performance (32%), and particularly of their market share (52%). The awareness of the level of rivals' pricing was not questioned in year one, but its popular mention led to its inclusion in year two. It turned out that 86% of respondents had an idea at what level their rivals were pricing.

The gathering of such information was a fairly frequent occurrence; every two months on average. Frequently, respondents said that it was an 'on-going thing', and that they gathered information as they came upon it. In fact, 99% in year one (98% in year two) said that they received intelligence through conversations, hearsay or 'gossip'. Newspapers were also an important source (65%), as were trade journals (57%), followed by the contacts they made through membership of trade associations (41%). The relatively frequent use of the latter supports Curran and Downing's (1993, p.145) finding that "business owners' commonest contacts after customers and suppliers were with accountants, bankers, chambers of commerce and trade associations". There was little change in the use of these sources from one year to the next, but electronic databases were becoming more common (from 9% to 18%), as was the use of government publications (from 12% to 16%).



Information Technology (IT) was defined for respondents as “the devices businesses use to transmit, store and process information” [*cf.* Porter and Millar (1991)], and so included phones, faxes and personal computers. Two-thirds (64%) replied, therefore, that IT was very important to their business in year one, 20% moderately important, and 15% just scarcely or not at all important. By year two, it was thought to be slightly less important in general, with 54% claiming it was very, 22% moderately and 25% scarcely important.

The phone was used by 99% of respondents in year one, followed by telephone answering machine (75%), fax (72%) and personal computer (71%). These were again the most commonly used by year two, and were all even slightly more important. There was also an increase in the use of cellular or mobile telephones (from 42% to 62%), electronic databases (from 40% to 50%) and electronic mail (email) (from 12% to 18%). Telephone and video conferencing were both rarely used, as were satellite links and radio communication (all less than 10%). Microfiche was used by only 5%, and was typically seen by those who actually knew what it was as being a piece of outdated technology.

By far the most popular use of IT in year one was for administrative purposes (95%), or keeping track of buyers and suppliers. It was next used for producing accounts (58%) and networking (57%) [*cf.* Steene (1991); McNicoll (1994)], or keeping in touch with contacts in the business to be aware of any changes. By year two, IT was only used by 40% for networking, although it was increasing in use as regards producing accounts (72%) and administration (96%). It was also more commonly used for forecasting or producing a business plan (from 48% in year one, to 55% in year two), and for designing new products (from 33% to 41%) [*cf.* Cooper *et al* (1991)]. Relatively few used IT to track the activities of their

competitors, though this amount was increasing (from 16% to 18%).

### *Quality Control and SWOT Analysis*

Quality systems and the recognised approval of such were not popular amongst firms in the sample. Only 15% in year one claimed to have installed a quality system [*cf.* Hand (1993)], from which it was hoped to gain mainly increased efficiency (31%), followed by better cost control (23%) and an improved business image (19%). Several claimed to have installed their own quality systems without the help of any external bodies or consultants [*cf.* Shuman and Seeger (1986)]: for example, “We have our own system, and sell the company by saying we have the safest chemicals and equipment”. One or two had used university business students on secondment, who would carry out an in-depth study of the business, perhaps as work towards an MBA, and then provide a suggested plan of action.

Few again had taken steps towards achieving a recognised formal quality approval, for example British Standard BS5750 or the international equivalent ISO9000 series. For the business as a whole, 17% (18% in year two) claimed to have made efforts in this direction. Less than 10%, though, in each case, had gained certificates or approval specifically for any of their products, operations or personnel. Of those who had, two-thirds (67%) thought quality approval of their products would lead to a better image; half thought approval for operations would lead to an improved image, and a half to increased efficiency; approval of personnel was thought to improve motivation (38%) and image (38%) equally, followed by increased efficiency (19%); and approval for the business as a whole was thought most likely to lead to a better image (50%), followed by increased efficiency (22%) [*cf.* Hanks (1993b)].

In firms where quality was actively being sought, and systems put in place to achieve this, it was commonly found that the respondent had gained knowledge of such systems through working in previous businesses, usually large corporations. However, they were not always convinced of its effectiveness: a typical comment, for example, was: "I have done it in a previous business, but it's not a guarantee of quality; because so many people have it now, it doesn't stand for quality"; "BS5750 involves too much administration"; "ISO9000 is too much disruption and cost to the business, and we would *lose* business through it"; and "We have our own system because BS5750 is such a disaster with other people - it's a waste of time".

Respondents were asked to perform a self-assessment of their strengths, weaknesses, opportunities and threats [*cf.* Johnson and Scholes (1984); Madu and Kuei (1993)]. In year one, their biggest strength was thought to lie in the quality of their product or service (25%) [*cf.* Bamberger (1989)], followed by their adaptability (17%) then faith in the business (14%) and their own technological or specialist knowledge (14%). By year two, product quality had increased in importance (to 31%), adaptability was still second (23%), and the respondent's innovativeness or generation of new ideas had increased in importance, with 11% now believing it to be their biggest strength.

In terms of weaknesses, respondents were often reluctant to admit to having any at all, so they were prompted to suggest the item that they would most like to improve upon. Market share came out top in year one, at 19%, followed by sources of finance (18%) and foresight or forward planning (11%). By year two, respondents were even more keen to increase their market share (27%), while sources of finance, an increase in product range, and an improvement in

organisation and systems were all thought to be equally important (14% each).

Respondents were most likely to think that new opportunities would stem from their product quality (16%) [*cf.* Bamberger (1989)], adaptability (15%) or their capacity for innovation and new ideas (14%). By year two, adaptability (19%) was thought to be a most likely source of opportunity, followed by product quality (18%) again. In year one, 12% suggested customers offered great opportunities, as did 10% in year two. However, this generally referred to an *increase* in customers, rather than the possibilities offered by existing customers. Although, therefore, opportunities are commonly thought to be external to the firm, most respondents focused instead on their internal strengths, hoping that improvement of these would, in turn, lead to new opportunities.

Very often, respondents saw few threats to their business but, when pushed, were able to pick out a major one from the list. The biggest threat to their business was thought to come from their rivals' market share (16%) in year one, then competition in general (14%) and rivals' plant and resources (13%). By year two, these were still identified as posing the largest threats, though competition was now thought to be the strongest (22%) [*cf.* Porter's (1980, 1985) 'Five Forces of Competition'].

When grading their business in terms of its strengths, weaknesses, opportunities and threats, respondents seemed a little uncomfortable, or even wary of, communicating a detailed and honest assessment.<sup>6</sup> Strengths, therefore, were generally over-rated, and weaknesses under-estimated. As for opportunities,

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<sup>6</sup> This supports evidence found by Reid, Terry and Smith (1997, p.46) of "the tendency to overstate returns and to understate risk" amongst firms trying to gain venture capital investment.

respondents were often quite unaware of where these might lie, and practically wrote off any thought of trading in Europe. They were similarly unaware of threats to their business, either from substitutes, government legislation or overseas competitors.

#### **4.4 Cluster Analysis**

The summary statistics and discussion presented above give a broad overview of the small firms covered in this study. As a general guide, it provides a useful basis upon which to build a more detailed picture. Further analysis now involves delving deeper into the underlying tendencies that lie hidden within the data. The way in which this shall be done is, first of all, by grouping the 150 firms into similar performance bands, using the method of 'cluster analysis'. This involves selecting a number of performance measures and then, one by one, grouping together in clusters those firms that appear to be 'most similar', in terms of these indicators, until all 150 firms have been assigned to a cluster. There can be any number of clusters between one (being all 150 firms together) and 150 (being all 150 firms separately), and it is up to the investigator to choose the number of clusters that best represents the groups he wishes to investigate.

The clustering is performed using three measures of performance available for all 150 firms in the sample. These are summarised in Table 4.2. *Employg* shows the percentage change in total employment from year one to two, which serves to give an indication of the investment by each firm into the tools by which it carries on its trade (*viz.* its workforce). A negative figure for *Employg* would indicate that staff

## PERFORMANCE MEASURES USED IN CLUSTER ANALYSIS

Table 4.2

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*EMPLOYG* = % growth in employees from year 1 to year 2

$$= \frac{Employ2 - Employ1}{Employ1} \times 100\%$$

*PROF2EQU* = Net profit (£) in year 2 divided by owner-manager's cash injection (£) at start

$$= \frac{Netprof2}{Owncash}$$

*SALESEMP* = Sales (£) in year 1 divided by total employees in year 1

$$= \frac{Sales1}{Employ1}$$

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cut-backs had been made, possibly because business was slack; whereas a positive figure would suggest that business was going well, and more people were required to carry out the increased workload.<sup>7</sup> A positive result for this variable therefore suggests good performance because an increase in expenditure on staff generally follows an increase in business (i.e. sales), leading to further expected future growth. Storey (1994, p.112) points out that small firms that “plan to and achieve rapid growth in employment [are] of interest [because] they are the major providers of new employment within the small firms sector, ... they are likely to purchase a wide range of financial services, ... [and] they are much more likely to be seeking a wide range of advisory services than is the case for firms experiencing modest growth or no growth at all”.

A further indication of business performance, and one that will be of interest to many small business owner-managers, is one that can assist those who hold a stake in the business in assessing the value and quality of the investment they have made. Ansoff (1965, p.42), for example, suggests that “rate of return on investment is a common and widely accepted yardstick for measuring business success ... [and] for comparison of business prospects in different industries”. An accounting ratio that measures such a return is the Return on Capital Employed, or ROCE. The variable *Prof2equ* is an approximation of this ratio, and measures the net profit earned by the business divided by the amount of financial capital injected by the owner-manager at the start of trading. A high figure here would represent a high return on the owner-manager’s investment, and therefore is taken to be an

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<sup>7</sup> In the long-term, a strategy might be to shed ineffective labour, or to ‘downsize’ the workforce in order to cut costs or because of technological innovations. This would make sense if the retained workforce were enhancing their skills, perhaps through training. However, here, we are observing short-term effects amongst very young firms, so the argument stands.

indication of good performance.

The third and final variable upon which the clusters are based is *Salesemp*. Similar to *Prof2equ* in that it represents a return on inputs to the production function, *Salesemp* measures the amount of turnover in year one that can be attributed to each employee; in other words, it is turnover in year one divided by total employment in year one. *Salesemp* is one indicator of the efficiency of the business in converting effort (in cooperation with other firm resources) into sales. The higher the value of this variable, the greater the sales attributable to each employee, which may be interpreted as a greater measure of productivity within the business.

It should be pointed out here that, in trying various clustering methods, some attempt was made to normalise figures such as sales and profit by age of the business. However, these results give no advantage over the simple sales measure, and it is to be noted, in any case, that the mean age is very similar across clusters. Table 4.3 shows the results of a one-way ANOVA<sup>8</sup> test for the age of the firm by the performance group to which it is assigned. The null hypothesis to be tested is that the mean value ( $\mu$ ) of *Age* (age of the firm, in months) is the same for each performance level, 1, 2 or 3:

$$H_0: \mu_1 = \mu_2 = \mu_3$$

If this hypothesis were true, the F-statistic generated would be close to one. Here, its value is 1.2535, with a probability of 0.2885, which falls outside the critical region, so we cannot reject the null hypothesis that the clusters come from populations with the same mean age.

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<sup>8</sup> ANalysis Of VAriance. See, for example, Wonnacott and Wonnacott (1969).



# ONE-WAY ANALYSIS OF VARIANCE FOR FIRM AGE BY PERFORMANCE LEVEL

Table 4.3

Variable	AGE				
By Variable	PEFORM				
Analysis of Variance					
Source	D.F.	Sum of Squares	Mean Squares	F Ratio	F Prob.
Between Groups	2	637.5188	318.7594	1.2535	.2885
Within Groups	147	37381.0746	254.2930		
Total	149	38018.5933			
Levene Test for Homogeneity of Variances					
Statistic	df1	df2	2-tail Sig.		
1.0424	2	147	.355		

Further confirmation can be attained from the results of the Levene Test for Homogeneity of Variance. The test statistic for this model, at 1.0424, is less than the critical value for  $F(2,147)$ , where  $F(2,\infty) = 3.00$ . This supports the finding above that we cannot reject the null hypothesis of homogeneity of variance. In other words, we cannot prove that the age of the firm has a statistically significant effect upon its performance, and must therefore conclude that other factors are responsible for the differences observed in performance.

Whilst the above argument may be used to refute claims that the performance indicator may be biased by the firms' ages, there remains one criticism that may yet be levied against the use of such a measure. That is, that performance may, to some extent, be dependent upon sectoral differences *viz.* services compared to manufactures. In earlier work [*cf.* Reid and Smith (1996)] sectoral dummies<sup>9</sup> were incorporated into a logit model to test for significance against the performance indicator described above. In fact, none were shown to have a significant effect on performance, and it was therefore concluded that, for young micro firms, it is not necessarily the sector in which they operate that is important so much as how they position themselves within that market and organise themselves to compete against rivals.

Statistical support for these findings is provided by Table 4.4, which shows the levels of high, medium and low performance cross-tabulated by the binary variable *SIC*, where *SIC* = 0 if the firm operates primarily in the manufacturing sector, and *SIC* = 1 if it is in services. The chi-square measures of association for this model

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<sup>9</sup> Two models were tested. In the first, nine variables were used to represent SIC codes at the 2-digit level. In the second model, a single binary variable was used to represent the distinction between services and manufacturing.

CROSS-TABULATION OF PERFORMANCE BY SIC

Table 4.4

SIC by PERFORM				
		PERFORM		
		Page 1 of 1		
SIC	Count			
	Exp Val			
	Row Pct			
	Col Pct			
	Tot Pct			
		1.00	2.00	3.00
		Row		
		Total		
	.00	32	20	2
		32.6	17.8	3.6
		59.3%	37.0%	3.7%
		35.6%	40.8%	20.0%
		21.5%	13.4%	1.3%
	1.00	58	29	8
		57.4	31.2	6.4
		61.1%	30.5%	8.4%
		64.4%	59.2%	80.0%
		38.9%	19.5%	5.4%
	Column	90	49	10
	Total	60.4%	32.9%	6.7%
		149		
		100.0%		
Chi-Square		Value		DF
-----		-----		-----
Pearson		1.60372		2
Likelihood Ratio		1.70787		2
Mantel-Haenszel test for		.07637		1
linear association				
				Significance
				-----
Pearson				.44849
Likelihood Ratio				.42574
Mantel-Haenszel test for				.78228
linear association				
Minimum Expected Frequency -		3.624		
Cells with Expected Frequency < 5 -		1 OF		6 ( 16.7%)

Note:

Definitions are: SIC = '0' = manufactures (SIC 0 to 49)  
SIC = '1' = services (SIC 50 to 99)

[viz. Pearson (prob. value = 0.449), Likelihood Ratio (prob. value = 0.426)] and M-H test for linear association (prob. value = 0.782)] are all insignificant, and therefore support the conclusion that, for the firms under examination here, the sectoral differences have little or no bearing on performance. As both firm age and sector are shown not to be significant, there must be other reasons for the observed differences in performance, which are investigated in greater detail below.

Of course, the measurement of performance is somewhat arbitrary, and what constitutes *good* performance will depend to some extent upon the needs of the users of the information, referring to firms generically, and the requirements by stakeholders in the company concerned. For example, employees will be interested in long-term job security and promotion prospects, and so will want to see evidence of management's investment in the workforce, in terms of, for example, training or pension plans. Holders of equity will be looking for a high return on their investment, and so will measure performance by profits available for re-distribution as dividends. And creditors will be interested in the liquidity of the firm, to satisfy themselves that invoices will be paid. See, for example, Jarvis *et al* (1996, p.13), who suggest that "business performance is not synonymous with profits nor with any other single indicator".

However, here we are investigating the prospects of very small, 'micro', owner-managed firms. The owner-managers is the major, and often only, stakeholder in the business, and will be seeking a good return for their investment of both time and money. In addition, a common aim amongst these businesses is that of growth, so measures of change in employment, profit over initial equity and sales per employee should indicate to some degree how successful they have been in achieving this goal in the short time they have been in business.

Having established the bases upon which clusters will be formed, it is now necessary to choose the method for performing clustering. The programme used for doing this, *SPSS*, has a wide range of possible alternatives, and many were tried before a satisfactory response was obtained. There are three points to consider when carrying out an agglomerative hierarchical cluster analysis.<sup>10</sup> First, the method for calculating the distance between two cases needs to be established; second, the method for combining the clusters should be ascertained; and third, data may need to be standardised or transformed before calculations can commence.

The method used here to estimate the distance between any two cases is the *Euclidean Distance* measure. Intuition for this can be gained by appealing first to Pythagoras' Theorem [Figure 4.1]. The theorem states that: 'the square of the hypotenuse of a right-angled triangle is equal to the sum of the squares of the other two sides'. In Figure 4.1 therefore, the distance between point *C* and point *B* is equal to the square root of the sum of the distance from *A* to *C* squared, and the distance from *A* to *B* squared. Algebraically, this is expressed by the following equation:

$$Distance((x_1, y_2), (x_2, y_1)) = \sqrt{(x_2 - x_1)^2 + (y_2 - y_1)^2}$$

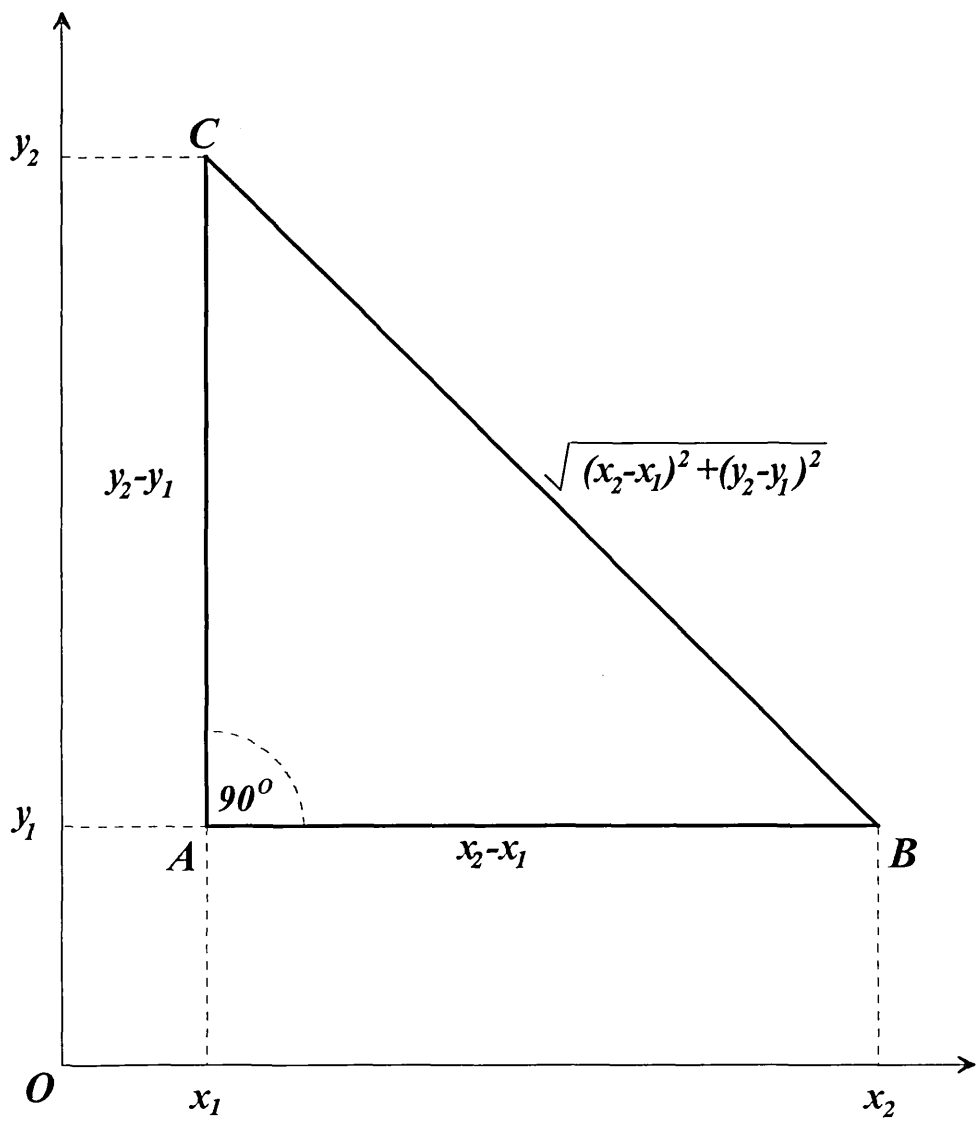
The shortest distance between the two points *C* and *B*, can therefore be deduced using Pythagoras' Theorem.

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<sup>10</sup> For further explanation on cluster analysis see, for example, Norusis (1994) *SPSS Professional Statistics 6.1*, Chapter 3: Cluster Analysis. See also Everitt's (1974) useful text, *Cluster Analysis*.

PYTHAGORAS' THEOREM

Figure 4.1



The Euclidean Distance measure works along similar lines to calculate the shortest distance between any two cases. It is an extension of the ideas behind Pythagoras' Theorem, and can be extended to multiple dimensions, which makes it ideal for multivariate analysis. Figure 4.2 shows a graphical interpretation of a three-dimensional Euclidean Distance measure. The distance between the two points  $A$  and  $B$  is now written:

$$Distance((x_1, y_1, z_1), (x_2, y_2, z_2)) = \sqrt{(x_2 - x_1)^2 + (y_2 - y_1)^2 + (z_2 - z_1)^2}$$

Extending this further, for  $i$  dimensions, the basic Euclidean Distance formula can be written as follows:

$$Distance(x, y) = \sqrt{\sum_i (x_i - y_i)^2}$$

This simply states that the distance between any two items,  $x$  and  $y$ , is the square root of the sum of the squared differences between the values for those items. Inserting the variable names used for clustering the 150 firms in the sample gives the following equation:

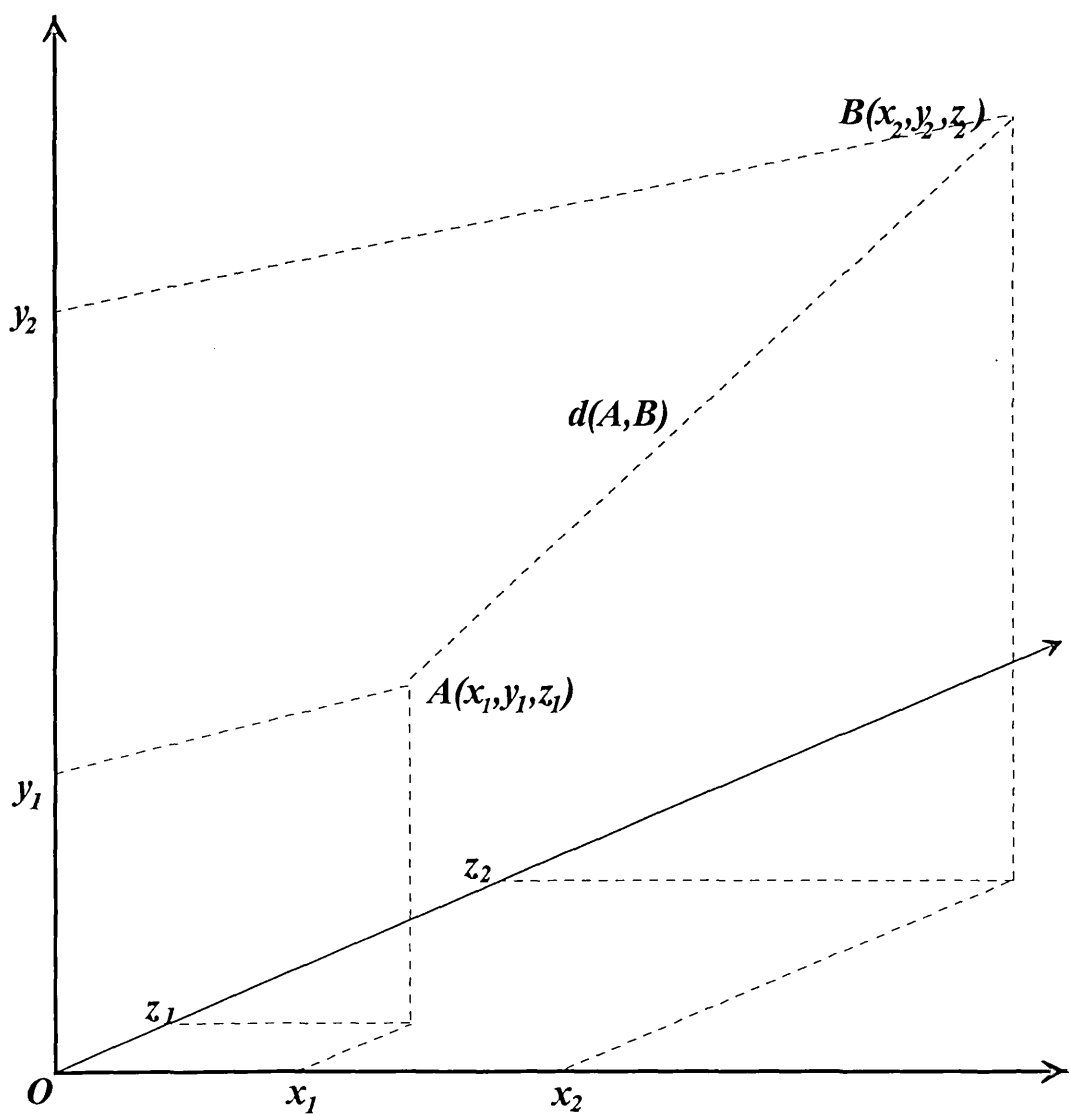
$$Distance(x, y) = \sqrt{(x_{EMPLOYG} - y_{EMPLOYG})^2 + (x_{PROF2EQU} - y_{PROF2EQU})^2 + (x_{SALESEMP} - y_{SALESEMP})^2}$$

So the distance between two cases or firms,  $x$  and  $y$ , is the square root of the sum of squared differences between the values of the three given variables.

Next, the method for combining the clusters should be selected. This will tell us

3 DIMENSIONAL EUCLIDEAN DISTANCE MEASURE

Figure 4.2



*Note: Adapted from Manly (1986, p.44) Multivariate Statistical Analysis*



which clusters should be joined at each stage of the cluster formulation. There are various types of methods to choose from, including linkage methods, variance methods and centroid methods. The method chosen is one which is used frequently, called *Ward's Method*, and it is calculated as follows.

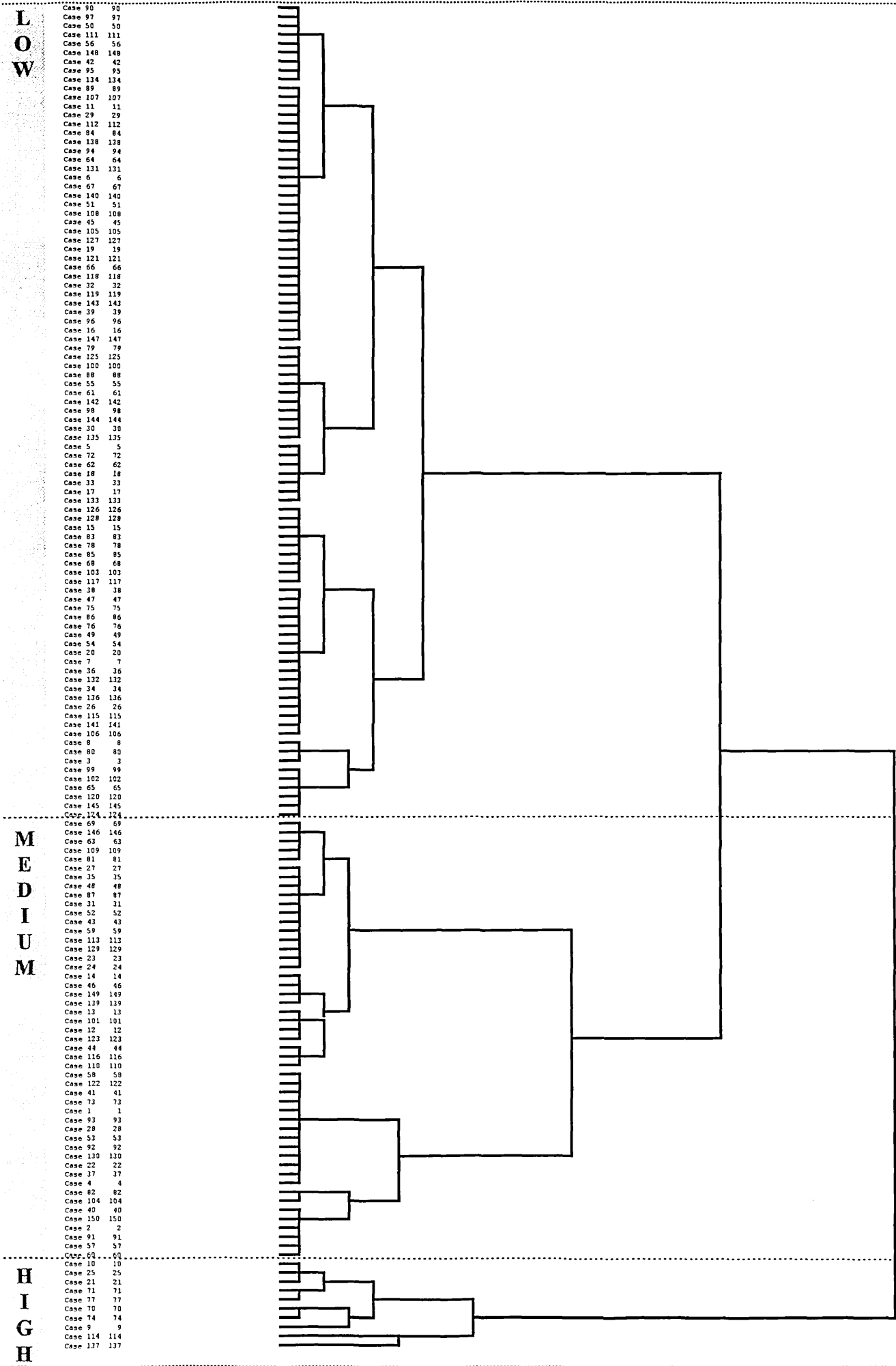
“For each cluster, the means for all variables are calculated. Then, for each case, the squared Euclidean distance to the cluster means is calculated. These distances are summed for all of the cases. At each step, the two clusters that merge are those that result in the smallest increase in the overall sum of the squared within-cluster distances”.

Norusis (1994, p.98) *SPSS Professional Statistics*

Having chosen both the method for calculating distances and for cluster formulation, it only remains now to ensure that the data are in a suitable form for analysis. As Euclidean distances are very sensitive to the scales of measurement used, variables must be standardised before clustering takes place. For example, a figure for *Salesemp* will likely have a much greater weighting in the equation than will the figure for *Employg*, unless the data are in some way transformed. All data are therefore standardised to fall between the range of -1 and +1, thereby ensuring that each variable is weighted on an equal basis [*cf.* Reid and Smith (1996)].

The data thus ready, the cluster analysis is run, and results show that firms can be allotted to one of three clusters. These are labelled, by performance groupings, ‘Low Performers’, ‘Medium Performers’, and ‘High Performers’. Figure 4.3 shows the dendrogram achieved from clustering the 150 cases. This is a graphical depiction of which case falls into which cluster, and works in a similar way to a decision-tree. Starting from the right, we see two branches breaking off into two clusters, then working left, a further breakdown into three clusters, and so on, until we have 150 clusters. The column on the left shows which cases fall into either of

Hierarchical Cluster Analysis: Dendrogram  
Figure 4.3



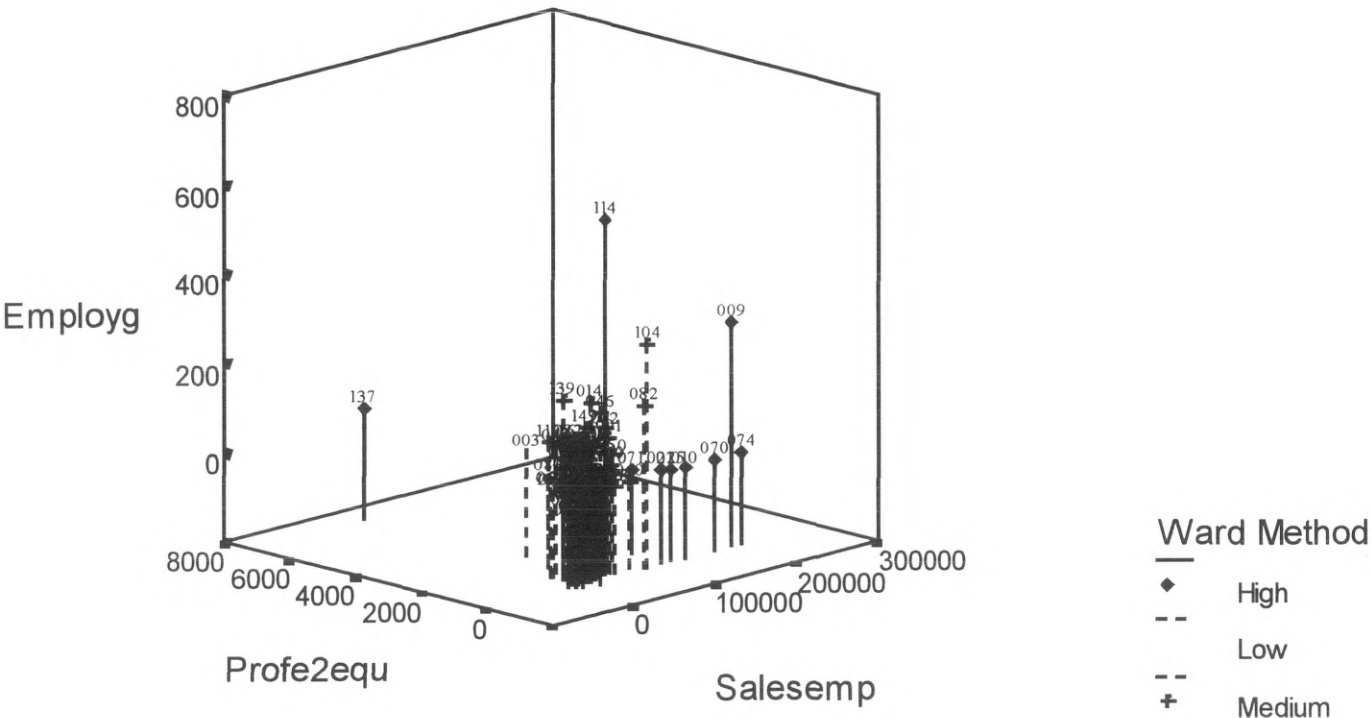
the low, medium or high performance brackets. The case number identifies the case and is identical to the label, beside it, which is the firm identification number - a number between 1 and 150.

A helpful discussion of the problems of cluster analysis is contained in the classic work of Everitt (1974). Perhaps the main difficulty is in deciding whether or not the clusters obtained do actually describe the relationships desired. Everitt (1974, p.45) describes clusters as “continuous regions of ... space containing a relatively high density of points, separated from other such regions containing a relatively low density of points”. For the firms under investigation in this work, Figure 4.4 shows a three-dimensional scatter plot of the clusters. The low and medium performers are grouped closer together and are therefore harder to distinguish, but the high performers stand out quite clearly from the rest.

Another problem lies with the choice of variables. As was mentioned previously, many different combinations were tried, but the three variables settled upon gave the best and clearest results. For one thing, data were available for each of the 150 cases. For another it was felt that the variables selected gave as good an indication of performance and measurement of growth as it would be possible to obtain using such methods. As a test of the reliability of the cluster breakdown, Everitt (1974) suggests trying several cluster techniques, based on different assumptions or using different variables, on the same set of data. Then, only clusters which are produced by all or the majority of these methods should be accepted. Several cluster analyses were therefore performed, using various performance measures such as simply staying in business, employment growth, asset growth and the ratio of profit to sales. They generally suggested a similar set of high-performing firms, with some, but not excessive, variance in the groupings of medium and low

3-DIMENSIONAL SCATTER PLOT OF  
PERFORMANCE CLUSTERS

Figure 4.4



*Note:* The scatter plot is based on absolute values, rather than the re-scaled values used to compute the clusters. However, it can still be seen clearly that the high performers stand out from the rest of the sample.

performers. It is therefore felt that the final clusters arrived at identify successfully the three main groupings.

Finally, as regards clustering, a simple analysis of the figures is sometimes not enough to assure the investigators of the validity of the clusters. Some element of subjective judgement must also be applied to decide which of the three clusters is indeed the high, or medium or low performance group. Firms from each cluster were identified by name, and the two main investigators who had first-hand knowledge of the businesses through face-to-face meetings, were agreed that the firms could legitimately be grouped into the three categories given, with no apparent anomalies.

Table 4.5 summarises the mean cluster variables, with standard deviations, for each group. First, let us consider the variable *Employg*, which measures the percentage growth in employment, or total headcount, from year one to year two. For the low performers, mean employment fell (*Employg* = -6.04), for the medium performers, it grew by 76.72 per cent, and for the high performers, it grew the most, at 97.92 per cent. The second variable in the cluster equation is *Prof2equ*, which measures net profit in year two divided by the owner-manager's initial cash injection. For the low performers, the mean value of *Prof2equ* is 117, for the medium performers, 137, and for the high performers, 1,036. Finally, the last cluster variable is *Salesemp*, measuring turnover in year one divided by total headcount, or sales attributable to each employee. For the low performers, the mean value for *Salesemp* is £15,120, for the medium performers, twice this, at £32,008, and for the high performers, an impressive £127,550.

The three variables are therefore consistent, each improving as one moves from

## MEAN VALUES FOR CLUSTER VARIABLES

**Table 4.5**

		<b>Low Performers</b>	<b>Medium Performers</b>	<b>High Performers</b>
		<b>n=91</b>	<b>n=49</b>	<b>n=10</b>
		<b>(=61%)*</b>	<b>(=33%)*</b>	<b>(=7%)*</b>
<i>Employg</i>	Mean (Std Devn)	-6.04 (18.10)	76.72 (63.65)	97.92 (199.49)
<i>Prof2equ</i>	Mean (Std Devn)	117.47 (349.93)	136.88 (262.79)	1,036.14 (2,236.01)
<i>Salesemp</i>	Mean (Std Devn)	15,120.70 (9,989.40)	32,007.52 (23,950.07)	127,550.30 (59,272.27)

*Notes:* \* There are some small rounding errors in percentages

*Employg*: percentage change in employment

*Prof2equ*: net profit in year two ÷ owner-manager's initial investment

*Salesemp*: sales ÷ total employment in year one.

the low, through the medium, to the high performers, and thus supporting the assumption that the groups into which the firms have been clustered accurately represent low, medium and high performing businesses. In terms of the growth (*Employg*), profitability (*Prof2equ*) and productivity (*Salesemp*) measures used here, the low performers have mean values that are smaller than those of the medium performers, which are in turn smaller than those of the high performers, for all three variables.

#### 4.5 Cluster Characteristics

Table 4.6 presents the mean values for several descriptive statistics, which help to give an idea of the firm characteristics in each group. Their definitions are included in Table 4.7. Before analysing these statistics, one or two points must first be noted. Some of the variables are for year two data, with 150 observations, whereas others relate to year two information, after which several firms had failed and, additionally, some were not available for interview, leading to missing observations. So there may appear to be discrepancies between some of the variables presented in Table 4.6 and those used to compute the cluster analysis. For example, one might assume that the mean value of *Prof2equ* can be calculated from the mean values of *Netprof2* and *Owncash*. However, this is not the case, as the ratio of two means (*viz.* *Netprof2* and *Owncash*) is *not* equal to the mean of the ratios (*viz.* *Prof2equ*). To prove this algebraically, it is asserted that:

$$\frac{\bar{X}}{\bar{Y}} = \frac{\sum x_i}{\sum y_i} \neq \frac{1}{n} \sum \frac{x_i}{y_i} = \bar{Z}$$

where  $\bar{X}$  = mean value of *Netprof2*  
 $\bar{Y}$  = mean value of *Owncash*  
 $\bar{Z}$  = mean value of *Prof2equ*

## MEAN VALUES FOR ADDITIONAL DESCRIPTIVE VARIABLES

**Table 4.6**

		Low Performers n=91 (=61%)*	Medium Performers n=49 (=33%)*	High Performers n=10 (=7%)*
<i>Inbusin</i>	Mean (Std Devn)	0.75 (0.44)	0.90 (0.31)	1.00 (0.00)
<i>Age</i>	Mean (Std Devn)	20.18 (17.83)	20.37 (10.68)	28.50 (19.15)
<i>Assets1</i>	Mean (Std Devn)	17,154.73 (32,470.95)	13,891.25 (20,636.60)	66,017.88 (135,564.05)
<i>Assets2<sup>†</sup></i>	Mean (Std Devn)	23,135.19 (46,014.64)	37,047.56 (86,403.83)	31,400.75 (36,172.94)
<i>Employ1</i>	Mean (Std Devn)	5.20 (6.90)	8.06 (23.28)	9.20 (13.18)
<i>Employ2<sup>†</sup></i>	Mean (Std Devn)	3.27 (6.20)	12.63 (44.34)	4.80 (3.61)
<i>Sales1</i>	Mean (Std Devn)	94,729.05 (180,129.44)	192,599.43 (371,865.10)	1,556,075.00 (2,892,615.86)
<i>Sales2<sup>†</sup></i>	Mean (Std Devn)	130,902.85 (228,614.09)	256,321.02 (520,141.26)	760,475.38 (721,130.70)
<i>Netprof1</i>	Mean (Std Devn)	7,873.29 (15,613.83)	21,695.11 (39,583.89)	23,000.00 (44,774.43)
<i>Netprof2<sup>†</sup></i>	Mean (Std Devn)	12,802.54 (41,024.27)	8,559.92 (17,832.35)	53,050.50 (50,607.31)
<i>Owncash</i>	Mean (Std Devn)	10,817.30 (24,475.76)	15,309.46 (37,650.43)	24,250.00 (34,602.85)
<i>Outeq</i>	Mean (Std Devn)	0.04 (0.21)	0.06 (0.24)	0.11 (0.33)
<i>Bankloan</i>	Mean (Std Devn)	0.27 (0.45)	0.39 (0.49)	0.44 (0.53)
<i>Grant</i>	Mean (Std Devn)	0.78 (0.42)	0.82 (0.39)	0.67 (0.50)
<i>Gearst</i>	Mean (Std Devn)	165.92 (359.83)	136.13 (290.27)	188.78 (322.54)
<i>Gearnow</i>	Mean (Std Devn)	182.46 (371.95)	167.40 (450.28)	43.33 (77.87)

*Note:* \* There are some small rounding errors in percentages.

† Computed on smaller sample size of 122.



## DEFINITION OF VARIABLES IN TABLE 4.6

**Table 4.7**

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<i>Inbusin</i>	=1 if the firm is in business in year 2, =0 otherwise
<i>Age</i>	age of the firm at first interview, in months
<i>Assets1</i>	value (£) of net fixed assets in year one
<i>Assets2</i>	value (£) of net fixed assets in year two
<i>Employ1</i>	total number of employees in year one
<i>Employ2</i>	total number of employees in year two
<i>Sales1</i>	value (£) of turnover in year one
<i>Sales2</i>	value (£) of turnover in year two
<i>Netprof1</i>	net profit (£) in year one
<i>Netprof2</i>	net profit (£) in year two
<i>Owncash</i>	value (£) of owner-manager's cash injection at start
<i>Outeq</i>	=1 if firm has outside equity investment, =0 otherwise
<i>Bankloan</i>	=1 if firm has a bank loan or overdraft, =0 otherwise
<i>Grant</i>	=1 if firm received a grant at start-up, =0 otherwise
<i>Gearst</i>	=gearing (debt/equity $\times$ 100%) at start-up
<i>Gearnow</i>	=gearing (debt/equity $\times$ 100%) at time of first interview

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That the equality does not hold, may be illustrated by counter-example:

$$\text{Let } \begin{array}{ll} x_1 = 9 & x_2 = 11 \\ y_1 = 18 & y_2 = 70 \end{array}$$

$$\Rightarrow \frac{20}{88} = 0.2272727 \neq \frac{1}{2} \left( \frac{9}{18} + \frac{11}{70} \right) = \frac{0.6571428}{2}$$

$$\Rightarrow 0.2272727 \neq 0.3285714$$

A discussion of the data presented should help to clarify these points, and enable us to gain an understanding of the characteristics of each performance group.

First, *Inbusin* tells us what percentage of firms were still in business in year two. All of the high performers were still trading, compared to 90% of medium and 75% of low performers. It might appear odd that 10% of medium performers should have failed; one might ask why these were not classed as low performers. The point is that some small firms are set up by ‘serial entrepreneurs’, who start a business with the sole intention of exploiting a profitable niche, before withdrawing and moving on to a new project. Ceasing to trade, therefore, is not necessarily an indicator of failure. The high performers are around 8 months older than medium and low performers, but the age difference is not statistically significant, as discussed earlier in this chapter.

*Assets1* and *Assets2* refer to the net value of fixed assets for years one and two; in other words, their value after depreciation has been deducted. For the first year, higher performers also had the largest asset base. For the second year, they were again larger than the low performers, although smaller than medium performers, on average. The differences can probably be explained by some missing observations in the second year, giving an unusually low asset figure for the high performers.

Later work might involve interpolation of the available data to generate more accurate measures.

In year one, the ranking of employment accords with the firms' performance; the larger they were, the better they performed, on average. By year two, however, both low and high performers had reduced their total employment. In the former case, this was probably to reduce costs in an effort to avoid failure; and in the latter, it was more likely to be to promote efficiency. For both years, sales accord with the ranking by performance, with the better performing firms generating a much higher turnover than the low and medium performers.

The net profit averages for year one rise according to performance rank, but for year two the medium performers show a smaller average figure than the low performers. The financial accounts of very small firms are not well regulated, so problems of measurement do exist. For example, the smallest, one-man business, might not even have formal accounts; the owner-manager may take money from the business as he needs it, and any balance remaining in the bank is the net profit. Firms with more formal management accounting practices will generate a net profit figure before taking directors drawings as a salary.<sup>11</sup> The measures used are clearly not consistent, but it is obvious here that the high performers do much better, in terms of profit measurements, than the lower performing firms.

The better the performance, the greater is the average initial cash investment by the owner-manager. The greater, too, is the percentage of equity held by the external investors, and the higher is the level of bank indebtedness, the better is

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<sup>11</sup> See, for example, Levin and Travis (1987), who discuss reasons why commonly used standard measures of financial performance cannot always be used to evaluate the small firm.

performance. By showing his commitment to the future of the firm, therefore, the owner-manager is able to attract further funding, in both debt and equity form, which, in turn, helps to enhance performance.

The level of grant or subsidy support is generally high, with 78% of low, 89% of medium and 67% of high performers receiving some kind of assistance. This is probably due, in part, to the fact that the sample was provided by the Enterprise Trusts, who allocate the Enterprise Allowance funds. The *Grant* variable is binary, and so only indicates the existence or absence of funding support, and not its level. However, whether or not a business receives such assistance would appear to be an irrelevant factor in predicting performance.

The gearing ratio at inception, measured as debt divided by equity, is highest for the high performers, which would appear to suggest a higher level of risk amongst these firms. However, all firms were relatively highly geared, with debt being, on average, greater than equity, for each performance level. By the time of their second interview, however, the high performers had reduced gearing from 189% at inception to only 43%, whereas both low and medium performers had increased their gearing. Such results support the view that high gearing at inception is acceptable, if it is followed by a rapid reduction soon afterwards [*cf.* Reid (1991)], with lower gearing being consistent with better performance.

This discussion of various other common indicators of performance has lent support to the assumption that the clusters generated are accurate indicators of firms' performance. The rankings accord particularly well with turnover, net profit, the owner-manager's cash injection, the level of outside equity and bank loans, and support the theory that the rapid reduction of a relatively high initial gearing is associated with better performance. The overall conclusion is that we

can be confident in the rankings suggested by the cluster method, and the variables used, and can take these rankings as a basis from which to analyse the strategies of low, medium and high performing firms.

#### **4.6 Summary**

Chapter 4 has discussed how a new database was designed, using *Paradox*, to hold all of the data from the administered questionnaire. The variables were of several types, including binary, categorical, real or integer, and text strings. Eight tables of data were formed; one for each section of the questionnaire, with an additional table to hold interview notes and business addresses. Extracts from the actual database are used to illustrate the methods of querying the database to draw out specific data for analysis.

The average firm's characteristics are then discussed under section 4.3, for years one and two of the study. The firms are shown to fall under the classification of 'micro' firms, with an average total headcount of less than ten in each year, and a main target market being the local area. The sectors into which the firms fall can be split roughly as one-third manufactures and two-thirds services, and the average annual sales figure is slightly under £¼m for both years examined.

The data from the STRATEGY table are then discussed for each year, under the headings of the administered questionnaire, by appeal to the data contained in Appendix II. It is found that the need for achievement and prospect of unemployment were important factors in the inception of these small firms. Main aims were for long-term profit and overall growth. Most firms had developed a

business plan at start-up, and their average planning horizon was a year-and-a-half in year two.

Funding had come primarily from the owner-managers themselves, followed by grants or subsidies, and bank loans. Most respondents gathered some information on rivals, and also thought information technology was of some importance to their business. Formal systems of quality management were uncommon, although firms occasionally had implemented their own systems. Main strengths were the product or service, weaknesses lay in the market share, opportunities were available through product quality and adaptability, and threats came largely from rivals' market share and competition in general.

Section 4.4 describes the method used to group the 150 firms into a ranking of low, medium and high performers. This was achieved through cluster analysis, using three measures of performance to group together those firms with the most similar attributes. The variables measured growth (as the percentage change in employment between year one and two), return on capital (being the net profit in year two over the owner-manager's initial financial injection), and productivity (being sales generated per employee in year one). It is shown that only a small percentage (7%) of firms fall into the high growth category [*cf.* Storey (1994)], compared to 33% of medium and 61% of low performers.

Finally, in this chapter, section 4.5 discusses some general characteristics of each of the three performance groups generated above. The rankings of these additional performance measures generally accord well with the clusters to which each firm has been assigned, most notably in terms of sales, profits, the owner-manager's commitment of personal cash, outside equity held in the firm and bank funding. High performers are shown to reduce an initial high value of gearing very quickly,

supporting Reid's (1991) assertion that lower gearing leads to enhanced performance. Overall, the clusters appear to divide the firms into realistic groups by performance level, and it is these groups which will now form the basis for the detailed analysis of Chapters 5 and 6.

## Chapter 5

### Case Study Evidence: environmental scanning and strategy formulation

#### 5.1 Introduction

Chapter 5 is the first of two chapters discussing the data generated by the additional semi-structured interviews with seventeen owner-managers. Making appeal to the resulting case studies contained in Appendix IV, it analyses data from the first two sections of the questionnaire, namely 'Environmental Scanning' and 'Strategy Formulation'. This analysis is performed by reference to the three performance groups (high, medium and low) into which the firms fall.

The qualitative evidence is supported by quantitative results taken from summary statistics of the earlier administered questionnaires. Conducting this analysis leads to the generation of five propositions about the performance of the small firm. These propositions are investigated, again using the data from years one and two of the administered questionnaire. Results are illustrated by the use of boxplots, graphs and cross-tabulations and supported with appropriate chi-square statistics.

First, let us consider how the seventeen firms in the case studies relate to the firms in the study as a whole. If we call the main group of 150 firms the 'full sample', and the firms examined by additional semi-structured interviews the 'sub-sample', we can compare the full sample and the sub-sample, looking at each of the high, medium and low performing groups in turn. Table 5.1 presents the statistics used in the cluster analysis, both for the 150 firms, and for the cases, individually,



# VALUES OF CLUSTER VARIABLES FOR FIRMS INTERVIEWED BY SEMI-STRUCTURED QUESTIONNAIRE

Table 5.1

	<i>Employg (%)</i>	<i>Prof2equ (%)</i>	<i>Salesemp (£)</i>
<b>High Performers</b>			
CASE C	300	0	200,000
CASE K	-17	1,158	122,396
CASE L	33	1,800	88,667
<i>sub sample mean</i>	105	986	137,021
<i>full sample mean</i>	98	1,036	127,550
<b>Medium Performers</b>			
CASE B	50	500	74,417
CASE G	60	808	50,000
CASE H	175	0	37,500
CASE I	17	67	40,504
CASE J	100	0	18,000
CASE N	0	0	43,400
<i>sub sample mean</i>	67	229	43,970
<i>full sample mean</i>	77	137	32,007
<b>Low Performers</b>			
CASE A	-25	0	12,744
CASE D	0	318	9,000
CASE E	-33	-96	21,667
CASE F	0	0	31,525
CASE M	-20	75	22,325
CASE O	0	200	16,000
CASE P	-29	157	9,000
CASE Q	0	91	19,717
<i>sub sample mean</i>	-13	93	17,747
<i>full sample mean</i>	-6	118	15,121

*Note:* *Employg* = percentage change in employment  
*Prof2equ* = second period profit ÷ initial equity  
*Salesemp* = sales revenue ÷ headcount in year one

and by average for their performance group. Looking, first of all, at the high performers, the firms interviewed by semi-structured interview seem to be representative of the high performers as a whole. The mean value for *Employg* is 98 per cent for the sub-sample, compared to 105 per cent for the full sample. The mean *Prof2equ* ratio is 986 for the sub-sample, compared to 1,036 for the full sample. And the *Salesemp* ratio is £137,021 per head for the sub-sample, compared to £127,550 per head for the full sample.

Turning now to the medium performers, we see that the value for *Employg* is 67 per cent for the sub-sample, and 77 per cent for the full sample. For *Prof2equ* the difference is more pronounced between the sub-sample (229) and full sample (137) means, but that the actual value is still very much smaller than for the high performers. And finally, as regards medium performers, the value for *Salesemp* is £43,970 per head for the sub-sample, and £32,007 per head for the full sample. Although, therefore, the medium performers who took part in the semi-structured interviews showed a slightly smaller percentage growth in employment, they performed somewhat better than the medium performers as a whole, in terms of the profitability and productivity measures used.

Finally, to the low performers. First, they show an employment decline, as measured by *Employg*, of -13 per cent, for the sub-sample, and -6 per cent for the full sample. The values for *Prof2equ* are fairly similar, at 93 for the sub-sample mean, and 118 for the full sample. And the values for *Salesemp* too are relatively close, at £17,747 per head for the sub-sample, and £15,121 per head for the full sample.

Taking all three performance groups, it is clear that the sub-sample of firms selected for semi-structured interviews are together reasonably representative of

the groups defined for the full sample: for each of the cluster variables, *Employg*, *Prof2equ*, and *Salesemp*, the mean value decreases as one moves down the performance scale. Obviously, taking the cases individually, there are slight discrepancies. For example, high performer *Case K* shows a value for *Employg* of -17 per cent, but this is offset by the high values for *Prof2equ* and *Salesemp*. Similarly, medium performer *Case N* shows values of zero for both *Employg* and *Prof2equ*, but is granted its status because of its relatively high value for *Salesemp*. In general, however, it is fairly clear why each case falls into the category it does, and that the 17 semi-structured interviews should give a fair indication of the performance characteristics of each group.

Table 5.2 now shows some additional descriptive statistics for the cases, again individually, and by mean for the group as a whole. The Standard Industrial classification (SIC) numbers, as identified by the owner-managers, and the firms' main markets are given to illustrate the sectors targeted by each firm. The SICs range from the chemical industry (25), through construction (50) to recreational services and other cultural services (97), with an emphasis on the service sector. The main markets range through every given option, from local, through regional, Scottish and British, to International, with little evidence to suggest that performance is related to market area.

In terms of age, the high performers investigated by semi-structured interviews were on average slightly younger (mean 17 months) than the full sample from which they were drawn (mean 29 months). They had a slightly smaller total number of personnel in year one (mean 5) than the full sample (mean 9). And turnover for the first year of trading considered by this study was £644,917 for the

**DESCRIPTIVE STATISTICS FOR FIRMS INTERVIEWED  
BY SEMI-STRUCTURED QUESTIONNAIRE**

**Table 5.2**

	<b>SIC*</b>	<b>months in business</b>	<b>headcount year 1</b>	<b>turnover year 1</b>	<b>main market</b>
<b>High Performers</b>					
<b>CASE C</b>	64/65	7	1	200,000	local
<b>CASE K</b>	61	19	12	1,468,750	local
<b>CASE L</b>	50	24	3	266,000	scottish
<i>sub sample mean</i>		17	5	644,917	
<i>full sample mean</i>		29	9	1,556,075	
<b>Medium Performers</b>					
<b>CASE B</b>	66/63	24	6	446,500	british
<b>CASE G</b>	83	30	5	250,000	local
<b>CASE H</b>	83	30	4	150,000	international
<b>CASE I</b>	46/66	31	53	2,146,725	british
<b>CASE J</b>	96	8	1	18,000	regional
<b>CASE N</b>	49	36	5	217,000	scottish
<i>sub sample mean</i>		27	12	538,038	
<i>full sample mean</i>		20	8	192,599	
<b>Low Performers</b>					
<b>CASE A</b>	43/96	15	4	45,000	local
<b>CASE D</b>	97	30	5	45,000	regional
<b>CASE E</b>	64/65	7	3	65,000	local
<b>CASE F</b>	50/66	8	4	126,100	british
<b>CASE M</b>	25/50	30	10	223,250	local
<b>CASE O</b>	83	20	1	16,500	regional
<b>CASE P</b>	50	20	7	63,000	scottish
<b>CASE Q</b>	96	18	2	39,500	local
<i>sub sample mean</i>		19	5	77,919	
<i>full sample mean</i>		20	5	94,729	

*Note:* \*Standard Industrial Classification number:

- 25 chemical industry
- 43 textile industry
- 46 timber and wooden furniture industries
- 49 other manufacturing industries
- 50 construction
- 61 wholesale distribution
- 63 commission agents
- 64/65 retail distribution
- 66 hotels and catering
- 83 business services
- 96 other services provided to the general public
- 97 recreational services and other cultural services

sub-sample, compared to £1,556,075 for the full sample.

The medium performers in the case study sub-sample were slightly older (27 months), on average, than both their own full sample (20 months) and the high performers. Their headcount too was higher, at 12 for the sub-sample, compared to 8 for the full sample. And turnover for the first year in the study was £538,038 for the sub-sample, compared to £192,599 for the full sample.

Finally, the sub-sample of low performers included in the case study analysis appears very similar to the full sample of low performers as a whole. They had been in business on average 19 months, compared to 20 months for the full sample. Headcount was identical, at mean value 5 for both the sub-sample and the full sample. And turnover was £77,919 for the sample, compared to £94,729 for the population.

In terms of turnover, the cases selected for semi-structured interview are consistent with the full sample of 150 firms, decreasing in size, the lower the performance. The main differences are that the medium performers in the case studies are, on average, slightly larger (in terms of headcount) and slightly older than the mean of their group as a whole; they are additionally somewhat older than the high performers. However, the clusters analyse firms by their performance over time, using three standardised measures, and not by reference to any one particular measure at only one point in time. It is assumed, therefore, that the relative age and headcount values will make little difference to the analysis of strategies by low, medium or high performers. This analysis now proceeds, by reference to the first section of the semi-structured questionnaire.

## 5.2 Environmental Scanning

The first heading under which the firms are discussed by performance group is that of 'Environmental Scanning'. It examines both internal and external factors affecting the business, in order to develop a picture of the owner-manager's awareness of the environment in which his firm operates [*cf.* Ansoff (1965)]. It discusses the rationale for the firm's inception, and the target market chosen, in terms of locality, price and quality. It then touches on the firm's relationship with suppliers and customers, and ends with an analysis of the firm's strengths, weaknesses, opportunities and threats.

### *High Performers*

The high performers had chosen to set up in their line of business, partly because they knew already something about the industry, but also for reasons that included spotting a new market niche, and being forced into it through a previous company going into liquidation. *Case C* said that "the fundamental reason was that it was a business with low set-up costs, and my access to capital was limited, I knew something about it, and I identified a gap in the market"; *Case K*, that "the company I worked for went into receivership"; and *Case L*, that "it's in the blood; I started in a family business, and took over my father's firm, but that went into receivership".

Two of the high performers targeted the local market at the time of interview: *Case C*, "purely because of logistics and the cost involved; it was convenient"; and *Case L*, because "it's easier to control" than a larger market. *Case K* thought that the Scottish market was the largest with which they could cope comfortably,

because “the roofing business is very parochial and relationship-driven”, so being able to maintain regular customer contact was vital.

In terms of price and quality, these firms said they aimed to provide an excellent product or service, at a competitive price, and took into consideration the market conditions prevailing at the time. *Case C* wanted “to be competitive, [although] with pricing, the industry standard margins apply”; *Case K* thought “we are competitive, and our rivals are cheap and nasty; we’ve been low price, low quality and high price, high quality, and over the last 11 years, through experience, our formula has evolved”; and *Case L* said that “we are on the quality end, [because] shoddy work neither lasts nor impresses”, and prices were “pre-set by the building trade, [where] the mark-up on labour is about 100 per cent, and the mark-up on materials, 20 per cent”. Their decision to provide high quality products supports Ward and Stasch’s (1988, p.27) assertion that “even if the product associated with a new strategy is not a new form of an already existing product, it can be a meaningfully different product to certain target markets if it is of higher quality than the competitor’s products”.

The high performers typically described their firm’s relationships with suppliers as good: we have regular suppliers and good relations with them; we have amongst the best deals available for a firm of our size” (*Case C*); *Case K* said relations with suppliers were “excellent”, although they were “bad at times on delivery”; and *Case L* said they were “very good, the quality is OK, and 75 per cent of the time they deliver on time”.

Similarly, relationships with customers were thought to be very good, with much repeat business through customer loyalty and word of mouth referrals, supporting the statement that “successful entrepreneurs depend on personal selling skills,

contacts, their reputations for expertise, and their ability to convince clients of the value of the services rendered [*cf.* Bhidé (1994, p.155)]. Complaints were few and far between. *Case C* said they would “build relationships with our customers and have a very high level of referred business”; *Case K* said that relations were “excellent with the majority” of customers, and that “we are now moving on to other customers; other people come to the trade counter [because] we have a higher profile site than before”; and *Case L* described his customer relationships as being “very good”, saying that “if any other work is wanted, they call us, and I don’t know of anyone we’ve lost”.

The biggest strengths identified by the owner-managers of the high-performing firms came down to the quality of the team of staff involved in running the business, and the quality of the product or service they offered, supporting the findings of, for example, Bamberger (1989). *Case C* thought that the biggest strength of his firm was “the values we have communicated to our customers before the sale, which are that we are friendly, professional, and have complete integrity, and we really *care* about the job we do”; *Case K* thought that their team spirit was important: “the boys are all self-starters, and they know their future is in the company”; and *Case L* thought their adaptability and product quality were major strengths: “we’re flexible enough to carry out any aspect of the trade, and we use it in our marketing” [*cf.* Carson (1985)].

The biggest strengths of these firms were often also thought to offer the greatest opportunities. *Case C* tried to exploit the opportunities provide by his staff, by trying to “give them autonomy and encourage them to innovate”; *Case K*, who thought the technological and specialist know-how of his in-house team of staff offered the business opportunities, would try to “piggy-back on the technology” of



their suppliers [*cf.* Reid, Siler & Smith (1996)], thus exploiting their innovativeness; and *Case L* tried to “keep producing the quality and service that the clients are looking for”, believing that this would enable them to take advantage of opportunities as and when they arose.

The high performers had identified weaknesses as being a lack of suitable skilled staff, poor organisation and difficulties in coming up with new ideas. However, since mentioning these weaknesses during the original administered questionnaire interview, they had often taken steps to improve upon weaknesses: “the situation has changed and things are getting better; we have more skills on board now and less things cause us hassle, we have trained someone and the team we have now are beginning to understand” (*Case C*). *Case K* had aimed to improve plant and resources, and said, “we have a warehouse now [but], with organisation, we don’t have enough people, and it’s not as organised as we’d like”. However, *Case K* was now registered as an ISO9000 approved supplier, which was a sure sign that the organisation was improving. *Case L* found planning for new ideas quite difficult, and said “we don’t market new products, but we use them when they arise”.

Finally, in this section, the high performers were unanimous in their opinion that rivals, or competition in general, posed the greatest threat to their firms, and so had decided to try and offer a slightly different product or service to combat this threat: “we operate in our own niche and are prepared to do things that the competition are not, we provide service above and beyond, and we are differentiated” (*Case C*); “we are battling and doing the business, and trying to develop the yard to stock slates and tiles outside” (*Case K*); and “you have to keep

up with it [i.e. the competition]; I have to beat their quality, service and price, and I give the *correct* information to clients” (*Case L*) [*cf.* Porter (1991)].

The high performers seemed to have clearly identified their market, and had chosen to provide a product that was equal in quality to that of their rivals, if not better, and competitively priced for the industry in which they operated, thus creating for themselves a competitive advantage [*cf.* Porter (1980, 1985); Bamberger (1989)]. They all had previous experience of their own particular industry, and had set up their own business partly because of this knowledge gained from working in other similar firms. They chose to restrict the market area they sold to, keeping it within a reasonable travelling distance, because the ‘hands-on’ approach and maintaining of customer contact was very important to their business. Relationships with suppliers and customers were generally thought to be good, with quality of delivery and regular suppliers, as well as repeat orders and customer referrals generating new business. The owner-managers were able to identify key strengths, an idea recommended by Thurston (1983), as being staff and product quality, and opportunities as being provided by these strengths. Weaknesses, too, could be identified, but steps had often been taken to improve upon these; and threats were thought to come primarily from competition in general. These high performing firms realised where the biggest threats came from, and adopted an aggressive and attacking manner, choosing to compete directly with rivals for the same customers; they were clearly focused on the market to which they wanted to sell, and tried to beat competitors, either through differentiation, in terms of quality, product range and service, or by cost-cutting and beating them on price [*cf.* Porter (1980, 1985); Reid (1993)].

### *Medium Performers*

Several of the medium performers mentioned having identified a gap or niche in the market, that they felt they could usefully fill, often having been trained in the industry through previous employment. *Case B* said “it was a natural progression”; *Case G* that “I felt there was a niche I could fit into [and] I wanted to be able to make my own decisions”; *Case H*, “it was something I was trained in, something I’ve always enjoyed, and the market sector seemed really buoyant”; *Case I* said that his previous employers “sold off the company I worked for, who then disbanded the in-house shopfitting division”; *Case J* “wanted to be independent and saw a gap in the market”; and *Case N* “felt there was a gap in the market place I could fill”.

The market areas targeted by the medium performers ranged from local to international. *Case G* said that “local markets are easier [because] you finger’s on the pulse, and you’ve got to get to know the business community”; *Case J* targeted the regional market because “just local wouldn’t work in this industry”; *Case N* sold to the Scottish market, because “there is not enough trade to support the business in the immediate area”; *Case B* targeted the British market because “it’s the market we know, and know well”; *Case I*, similarly, targeted the British market because “you have to go where the work is; it’s a national thing, and we are a member of the National Association of Shopfitters”; and *Case H* targeted the international market because “of all the sectors, it fits that one best; it offers the best market, the best growth and the most opportunity for a small company like this”.

The levels of price and quality offered by the medium performers were often based on what competitors were doing. *Case G* wanted “to go on a like-for-like

service, but we were offering the extras that they [i.e. rivals] didn't; I looked at what the customer wanted"; *Case H* said that "quality has to be the best it possibly can [and] price has to equate with costs"; *Case I*, that "you're only as good as the quality you can produce; if it's not of a high standard, then you'd not be considered on any tender list; the rates are based on what we need to achieve a break-even [point], and it has a lot to do with what rivals price at"; *Case J* decided upon price and quality "from seeing what the competition was doing, and from supplier prices"; and *Case N* "wanted to do the price that would give a good return on the finances invested in it, whilst offering the customer a good price".

These firm's relationships with suppliers were sometimes good, and sometimes variable. *Case B* said that they were "good, and we do get favouritism"; *Case G*, that they were "awful" as he was forced to buy from "The Channel", through distributors and dealers; *Case H* said "they give us discounts, which are probably similar to those of other companies"; *Case I* said "delivery is first class, and we see our suppliers as partners of ours"; *Case J* thought suppliers were "understanding of cash flow problems [as] I cannot always pay on time"; and *Case N* said "it differs from one to another" and was "very variable", but that "the mark of success is how a business deals with the problems that arise".

Again, the medium performers were very happy with their customer base. *Case B* enjoyed "a high rate of repeat business, and few or no complaints"; *Case G* thought "all customers love us [and] keep coming back"; *Case H* described their relationship as "a partnership"; *Case I* said they were "first class, measured by repeat business"; *Case J* said "I get repeat business, and word of mouth is important"; and *Case N* said "we have a lot of good accounts and repeat orders, and not a lot of complaints".

Medium performers generally thought that their biggest strengths were their employees, the quality of their products and their specialist knowledge about the products. They tried to capitalise on their strengths in various ways: *Case B* would “run training and incentive programmes [because] too many businesses underestimate the physical cost of staff turnover; so if you keep good staff, it saves you money”; *Case G* invested in “staff training, we pay well, we make sure they’re happy, and give them the perks that come with a good job; pay a good wage and they become loyal to you and don’t leave you”; *Case H* said “our level of management and process control is vastly superior to other companies, which makes us much more efficient”; *Case I*, that “as we get stronger and bigger, our competitive edge becomes sharper than that of the smaller companies”; and *Case N* believed that “I can put a good product on the market-place, with an attractive style and price, and it will be a blessing to people”.

Opportunities for these firms lay in many diverse areas. *Case B* thought that government legislation would require much re-training, the programmes from where the majority of their conference clients came, saying “we ring our contacts and ask where the training courses will be carried out, and who will be running them”; *Case G* thought opportunities lay with staff, and said “we invest in training, our competitors don’t”; *Case H* took advantage of his staff’s specialist knowledge “by developing unique and custom technologies for our games” [*cf.* Porter’s (1985) ‘primary activities’ (*viz.* Operations) in his *Value Chain*; Porter and Millar (1991)]; and *Case I* thought their new brochure offered opportunities, as “we have had the brochure for a year, and the dividends have been enormous; we adjust the brochure to the client’s needs”.

Weaknesses amongst the medium performers came down to a lack of specialist knowledge, under-funding, poor management and bad planning. *Case B* explained that “we wanted to buy another, existing, business, but we lacked the expertise to run it on a day-to-day basis; new opportunities need existing skills”; *Case G* said that “with a growing company, cash flow is always a problem, and we have relied very heavily on the bank until recently”; *Case H* had improved its organisation, with its “own systems, which are *like ISO9000, where we want them to be*”; *Case I* had “made a lot of inroads with management; we’re getting there now”; but *Case J* thought “forward planning is still bad, [although] the product range has increased”; and *Case N* was trying to improve his firm’s market share, “by a constant effort to spread the knowledge of our own product further afield, to appoint agents and open new accounts”.

Medium performers were more likely to think that threats were the kind of things that would affect the whole market, than to think, as high performers did, that rivals were the biggest threat to their firm. *Case B* was worried by red tape, and by the laws and by-laws, and Health and Safety requirements, saying “you often contravene them unknowingly”; *Case G* thought that a potential threat would be “rivals spotting the gaps I’ve identified”, but added that “they don’t seem to *want* to copy us”; *Case H* said that “it’s not a particularly threatening market”; *Case I*, that “construction can be a nightmare for getting payment from; if there’s a choice, we will always drop the construction client”; *Case J* was “aware of [rivals], but not bothered at the moment”; but *Case N* was aiming for “efficiency in manufacturing, so you have a price advantage over them”.

The medium performers had often spotted a niche that, because of their skills, they thought they could fill [*cf. Baker et al (1994)*]. The area their market covered

seemed dependent upon the industry, and ranged from local to international, but whichever it was, they all seemed to have a good awareness of who were their target customers. Quality was often based on that of rivals' products, and tended towards the higher end of the scale, with price being competitive and set at a level aimed to cover costs, with a comfortable profit margin. These firms were generally on good terms with suppliers, often able to negotiate discounts or payment conditions, and customers were thought to be plentiful and good, in terms of repeat business. Medium performers knew where their strengths lay and tried to take advantage of them, and of the opportunities on offer. Again, they knew what were their weaknesses, and some had taken steps to remedy them, improving their organisation, product range and marketing. They were less likely, however, to admit to feeling any threats, mentioning only what *would* potentially cause problems. Only one, *Case N*, seemed to think that rivals posed the greatest threat, and was taking active steps to compete directly with them.

### *Low Performers*

Many of the low performers seemed to have fallen into the line of business they now ran, either by chance, or because the firms they had worked for previously could no longer afford to keep them on as paid employees. *Case A* said "it's all I can do, so I was forced into it, and the town hasn't got a lot of competition for this line of work"; *Case D* had worked "in the industry before, down in England, and I thought there was a gap in Scotland"; *Case E* said "I don't know really" why he had started the line of business, but he had "always been interested in music"; *Case F* "were all made redundant from our employers, who worked in this type of business"; *Case M* said "the company we were with was closed down"; *Case O*,

that “I always wanted to be my own boss, and the illustration side was very lucrative at the time”; *Case P* said “we were all made redundant, and I went out on my own”; and *Case Q* had “lost my other jobs through cutbacks, and I’d always wanted to start my own business; it was the only thing I knew”;

Most of the low performers found that the majority of their work came from the local or regional market, although some went further afield for business. *Case A* said “if we covered a larger area, costs would be bigger; it consumes more time and is more expensive to do it”; *Case D* targeted commuters to the city, covering “a 35-40 mile radius”; *Case E* had simply “opened the shop and hoped it would make a profit we could live on”; *Case F* had started off with their previous employers, but moved to a national audience “because English companies were working up here; now 80 per cent of our business starts from a non-Scottish source, although 95 per cent of it is done in Scotland”; *Case M* targeted the regional market because “it was the one we were familiar with”; *Case O* had “started off locally, because I was known in the area”; *Case P*’s market was Scottish, because “you’re put on tender lists and the jobs can be anywhere”; and *Case Q* targeted the local market because “I knew a number of people and had built up customer relationships with them”.

Most of the low performers aimed to offer a good or high quality product, although several offered a range of products from very low to very high quality. *Case A* would “like to give the best quality I can”; *Case D* said it is “always high, because you’re dealing with children”; *Case E* would “go for good quality, though I keep some cheap rubbish to let them think they’re getting a bargain; quality is cheaper in the long run, and you don’t get so many returns or faulty products”; *Case F* said “quality has always been reasonably high, because of the type of work



[our previous employers] did”; *Case M* had been “doing it for that long that we worked out what our company needed, so quality is high”; *Case O* said that, for his industry, “quality is your own illustration style”; *Case P* had “always believed in ‘doing it right’”; and *Case Q* said “there are markets for high and low quality, and we go for everything”.

Pricing amongst low performers was often based on cost plus a mark-up, or pre-determined profit margin. *Case A* said it was “based on expenses and what we think”; *Case D* “worked out what it would cost me and added 20 per cent on”; *Case E* used “a percentage mark-up, and [would] round it up or down”; *Case F* used a pricing structure they had developed for their previous employers, “but we add on 20 to 25 per cent extra”; *Case M* said “price is based on our knowledge of other industries, and what we need to survive, plus profit”; *Case O* priced at the same level as competitors; *Case P* gave “value for money”; and *Case Q* said “price is dictated by the suppliers, [who] put the price in the catalogue”.

On the whole, the low performers were happy with their suppliers. *Case A* had “regular suppliers” and received “a small discount if we pay them on time”; *Case D* said “they favour us”; *Case E*, that “they all compete head-on with one another; they are not always on time, and I refuse to take late deliveries”; *Case F* said “we get a good deal and service” from suppliers; *Case M* received discounts, “but not more than our rivals”; *Case O* said “the quality of the goods is fine”; *Case P* said “I don’t buy anything without getting a discount”; and *Case Q* had “two main suppliers, and they look after us”.

These firms also claimed to have good relationships with their customers, who would often make repeat orders. *Case A* said “it must be very good, because most of them come back, and I’m happy with the number of customers”; *Case D* said

“most of our business comes from word of mouth, so it is imperative that we create the right impression”; *Case E* said, “we now get a lot of customers coming back”; *Case F* said “we rely on repeat business”; *Case M* received “repeat orders from larger clients”; *Case O* has experienced some trouble because “companies are keeping orders in-house and cutting back a lot on their spending”; *Case P* said “we get repeat orders from virtually the whole lot of them”; and *Case Q* admitted that, in order to keep the customer happy, “we’re too soft sometimes”.

Low performers said that their strengths were in the quality of their product or service, and the knowledge or experience of themselves and their staff. *Case D* used the staff quality in his advertising; *Case E* would “bend over backwards for our customers”; *Case F* relied on their specialist knowledge to mark them out as being “different from the bog standard plumbers and electricians”; *Case M* thought that “we, as owners and directors, take a more personal interest in the business than if we were working for someone else”; *Case P* thought he could “get work out of the way they [i.e. the staff] are trained, the way they conduct themselves, and the way they look”; and *Case Q* thought their experience was important, because “we know how to tackle most jobs and have probably done them sometime during the course of our career”.

Opportunities were thought to lie with the firm’s product quality, their adaptability and, for some, in new ideas or technological change. *Case A* thought quality was useful, because “we get 90 per cent of our work from recommendations, and quality speaks for itself”; *Case D* tried to be “as flexible as possible; we will adapt our business to the client’s needs”; *Case F* said “we are flexible and, if we saw an opportunity to diversify from our own standard, we would take it”; *Case M* said “when you deal, you deal with us, rather than a name

on the phone; we treat our customer better”; *Case O* thought that his adaptability offered opportunities for entering new market niches, because “I know I can turn about and do military illustration”; *Case P* said “we get a lot of our work from recommendation, or people are sufficiently impressed by what you say that they give you a try”; and *Case Q*, who thought new technology offered them opportunities, were “saving time by having the computer, and we are the only ones in the area to have it”.

When asked what were the biggest weaknesses in their firm, low performers were most likely to suggest plant and resources, or finance, a lack of staff, and a small market share or client base. *Case A* had “very limited access and parking area”, and said “we can lose customers because of it”; *Case D* had improved on his staffing problems, but still wanted to make a part-timer full-time; *Case E* was trying to improve his market share by “targeting different areas on different days”; *Case F* had improved their customer base, “but could probably do with expanding it again”; *Case M* said advertising was helping them to gain more business; *Case O*, too, said “getting out there and visiting clients” was helping; *Case P* had “pretty well bought the last bit of equipment I think we need” and said “turnover has gradually built up”; and *Case Q* aimed “to get the computerised work-station, so we could then accept bigger jobs, which we haven’t sought in the past”.

Several of these firms thought that rivals’ market share was a great threat to the existence of their own business, while others thought red tape or government legislation was a major problem. However, they were not always actively trying to do anything about such threats. *Case A* would “just plod on and stick to our guns and our principles”; *Case D* said “with government legislation, you have to go with the flow”, although he did also “try to keep a tab on what rivals are doing and

match the activities they're undertaking"; *Case E* thought that larger rivals could "compete on a more level playing field"; *Case F* said that "the competition is basically one guy, and we've all found our own niche"; *Case M* would "try to do better all round, and be more honest than our rivals"; *Case O* used "vigorous marketing and cutting my price" to try and take some of his rivals' market share; *Case P* thought that "red tape ties me to the desk, rather than talking to people"; and *Case Q* was "not really doing anything" about rivals, because "we are only interested in our own price, and I hope the word will spread about our quality".

The low performers had quite often been forced into self-employment through redundancy, or as an alternative to retirement, and they usually had some previous experiences of the trade into which they moved. They tended to work within the local or regional market because it was easier and cheaper than moving further afield. Low performers hoped to provide a good quality product at a competitive price, although some would offer a whole range of quality and prices. They rarely said that rivals had influenced either their price or quality. These firms enjoyed relatively good relations, both with suppliers and customers. Delivery and the quality of supplies were satisfactory, discounts sometimes given, and repeat orders or customer referrals were important for generating extra business. The low performers were able to identify strengths and hoped that these were enough to draw in extra customers in and of themselves. Similarly, they could identify opportunities, or things that they thought would offer opportunities, and were sometimes able to say how they might exploit them. Where the low performers had identified weaknesses, they had sometimes taken steps to improve them, but they were less likely to have done anything to combat potential threats, often believing that there were few, if any, that could affect their business.

## *Conclusions*

The high performers had clearly defined reasons for starting up in their line of business, often having spotted a niche or gap in the market, identifying set-up costs [cf. Porter's (1980, 1985) 'cost and differentiation focus'] and a knowledge of the industry as being important, and having a history of entrepreneurship in the family. Medium performers, too, had often identified a new niche, and commonly wanted to be able to make their own decisions. Low performers, on the other hand, were often quite vague about why they had started up in their particular line of business [cf. Kayser (1990)]. They were the most likely group to have been forced into it, often through redundancy, rather than having chosen to become self-employed. Again, they often had experience of the industry, although some were completely new to their chosen line of business [cf. Johnson and Scholes' (1984) 'corporate level strategies'] .

The high performers wanted to control the area they targeted because customer relations were very important to their business, and they wanted to be able to maintain a close contact with clients. Medium performers were also quite clear about the reasons for targeting the area they did, even though these ranged from local to international markets, for industry-specific reasons. The low performers were restricted to the local or regional market because it was simpler. In any case, they often seemed not to target a specific market, but rather to take business as and when it arose, from wherever it came.

High performers took into account the levels of rivals' price and quality when deciding upon their own products' standard and price, supporting the idea that "when starting out in a new venture, it pays to learn from others who have gone before" [Hay *et al* (1993, p.39)]. They aimed for a high quality, but at a

competitive price. The medium performers, too, paid attention to competitors, and tried to offer at least as good a quality as them, at a price that would cover their costs and generate a profit. Low performers were the only ones to offer low quality products at all, although the majority aimed for a high quality good wherever possible. Quality was reflected in their pricing structure. The low performers were the most likely group of firms to set quality and price without reference to rivals, simply choosing levels with which they were happy, and that would let them earn a small profit, after covering costs.

Firms across all three performance groups claimed to enjoy good relationships with suppliers, who provided a satisfactory quality of goods, and occasional discounts. Delivery was the major difficulty, where one was mentioned, with problems of timing causing most concern. Again, nearly all firms were happy with their customer relationships. They were satisfied with the clients they had, often unable to cope with any more, they received repeat orders from the majority of customers, and referrals were an important method of gaining new business. It is hard to differentiate between the owner-managers' perceptions of the quality of relationships with external contacts, in terms of the performance group into which they fall. Perhaps there is a tendency for the lower performers to overestimate the efficacy of customer relations in generating further business<sup>1</sup>, or perhaps the firms' relationships have little effect upon the overall quality of their performance.

The high performers were very clear about the strengths of their firms, and used these to impress the customer, and to try and persuade them to buy. Medium

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<sup>1</sup> See, for example, Bhidé (1994, p.155), who suggests that "good management practices like listening to customers, maintaining quality, and paying attention to costs, which can improve the profits of a going business, cannot propel a start-up over ... structural barriers [such as patents, location and brands]. Here a creative new technology, product or strategy is a must".

performers, too, knew what were their strengths, and did their best to capitalise on them [*cf.* Johnson and Scholes (1984); Kay (1993)]. In addition, low performers were very good at pointing out what they thought were the strong points of their business. Opportunities were clearly identified by high performers, who tried to exploit them to the best of their ability. Medium performers were also able to identify opportunities, and methods they were using to exploit them. However, low performers seemed to have more trouble in identifying existing opportunities, stating more often that things that were, in effect, their strengths *would* offer opportunities, but often being unable to specify how they took advantage of these.

Weaknesses amongst high performers had often been made better since the initial interview, and these firms were willing to accept that there were things upon which they could and should improve. The medium performers were also still trying to improve upon weaknesses, being clear about what these were. Low performers, when asked about weaknesses, had often found it difficult to identify one, but were more forthcoming when asked what aspects of their business they would like to improve upon. They too were trying to improve upon their weaker points, but were less satisfied with progress than were the higher and medium performers, often believing such things required more work on their part.

High performers were the most likely to be sure that rivals, or competition in general, posed the biggest threat to their business, and to be taking active steps to combat this threat, using both cost and differentiation to achieve their goals. Medium performers were less likely to compete head-on with rivals in the way that higher performers did, and were more inclined to believe that they posed little or no threat. Again, low performers had slight problems in identifying threats, but many seemed to think that the fact their rivals had a greater share of the market

was potentially harmful. Despite this, they were unlikely to try and do anything about potential threats, often believing that they could carry on their work, regardless of rivals' activities, and that, in any case, there was little they could usefully do.

### *Supporting Evidence*

To augment this analysis of the firm's 'Environmental Scanning', a new variable was generated from a combination of the respondent's perceived strengths, weaknesses, opportunities and threats, using data on the 150 firms interviewed by the administered questionnaire. Fifteen variables<sup>2</sup>, common to all groups, were taken together to generate the net strength variable *Strweak*. Strengths ( $\alpha$ ) were valued on the scale of 0, 1, 2 and 3, with 0 being the weakest, and 3 being the strongest. Similarly, threats from rivals or other sources ( $\beta$ ) were scaled as 0, 1, 2 and 3, with 0 representing no threat, and 3 a very strong threat. *Strweak* is a measure of the sum of net strengths, as perceived by the respondent, of his firm vis-à-vis his rivals or external threats, measured as  $\alpha - \beta$ .

So, for example, if a respondent rates his adaptability as '3', or very strong, and his rivals' level of adaptability as '1', or posing a weak threat, then the net value for the variable *Adapt*, for this firm, would be  $3 - 1 = 2$ . In other words, the respondent believes his adaptability is relatively stronger than that of his rivals. Conversely, if he rates his image as '1', or relatively poor, and his rivals' image as '3', or a very strong threat, then the value for this firm, for the variable *Image*,

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<sup>2</sup> Adaptability, forward planning, plant and resources, managers, employees, product quality, product range, organisation's structure/systems, customers, suppliers, market share, technological or specialist know-how, innovativeness/ new ideas, image, breakdown of barriers to trade in the EC.



would be  $1-3 = -2$ . In other words, he believes his image is relatively poor compared to that of this rivals.

Figure 5.1 expresses this, simply, in algebraic form. The variable *Strweak* is essentially an index measurement ( $I$ ) of the net effect of strengths versus threats to the business, calculated as described above. It takes the fifteen variables of comparison ( $i$ ) and sums the resulting figures to give an index value ( $I$ ) for each firm ( $j$ ). For cases where  $I_j > 0$ , the firm is said to believe, on balance, that it is relatively stronger than its rivals; for  $I_j = 0$ , the firm believes, on balance, that it is on a par with its rivals; and for  $I_j < 0$ , the firm believes, on balance, that rivals are relatively stronger. The proposition to be tested, prompted from earlier discussion of the data, is thus as follows:

- P<sub>1</sub>: most firms in the early stage of their life-cycle are prone to an over-exaggeration of their own strengths, and an under-estimation of threats from rivals and other factors external to the firm.

Having calculated the *Strweak* index for each of the 150 firms in the study, the so-called boxplots of Figure 5.2 were then generated.<sup>3</sup> These plots show the dispersion of results for the net strength index  $I_j$ , grouped by the firms' performance levels of 'low', 'medium' and 'high'. They are a good visual aid to

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<sup>3</sup> Boxplots, sometimes called box-and-whiskers plots, display summary statistics for the data. The box contains the values for fifty per cent of cases, from the 25<sup>th</sup> to the 75<sup>th</sup> percentile, and the length of the box corresponds to the interquartile range. The line through the box is the median value (i.e. the value of the middle item when the items are arranged in an increasing or decreasing order of magnitude [cf. Freund and Williams (1970)]), and its position within the box determines the skewness of the distribution viz. the line cuts through the centre of the box when the mean equals the median and the distribution is perfectly symmetrical; the line is to the top of the box when the mean is less than the median and the distribution is negatively skewed; and the line is to the bottom of the box when the mean is greater than the median and the distribution is positively skewed. The 'whiskers' extend above and below the box to the largest observed value that is not an outlier. Outliers and extreme values are denoted by 'O' and '\*', respectively. See, for example, Norusis (1993, p.186) *SPSS Base System Users Guide* for further explanation on how Boxplots are constructed.

## CALCULATION OF INDEX ( $I$ ) OF NET STRENGTH OF FIRM $j$

Figure 5.1

$$Strweak_j \equiv I_j = \sum_{i=1}^{15} (\alpha_{ij} - \beta_{ij})$$

where

$i$  is the variable being measured, = 1, 2, 3 ... 15

$j$  is the firm's identity number, = 1, 2, 3 ... 150

$\alpha$  is a measure of the firm's own strengths, = 0, 1, 2, 3

$\beta$  is a measure of rivals' relative strengths, = 0, 1, 2, 3

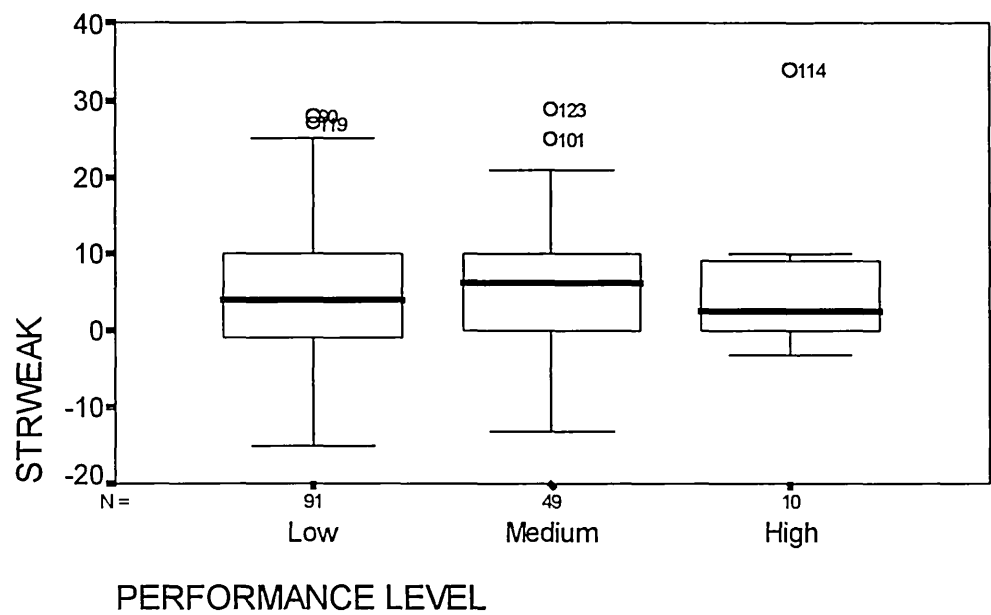
$I_j > 0 \Rightarrow$  firm believes it is relatively stronger  
than its rivals

$I_j = 0 \Rightarrow$  firm believes it is as good as, but no  
better than its rivals

$I_j < 0 \Rightarrow$  firm believes rivals are better than it

**BOXPLOT OF PERCEIVED NET STRENGTHS  
BY PERFORMANCE GROUP**

**Figure 5.2**



the pattern of the data, and help comprehension and inferential analysis. First, it is to be noted that the boxes look very similar across performance levels, in terms of the spread of results, with a minimum of roughly zero, and a maximum of roughly 10. Next, the 'whiskers' of the boxplots, are longest for the low performers, shorter for the medium performers, and shorter again for the high performers. This contraction of the dispersion of observations, as one moves from the lower to higher performing firms, suggests that the high performers are closer to giving a better estimate of their own ability, and a more accurate appraisal of their relative strengths, than are the lower performers, who range from being highly optimistic to highly pessimistic, providing support for theories of entrepreneurship [*cf.* Jovanovic (1982); Frank (1988)] that emphasise the relatively rapid learning of skilled entrepreneurs.

The low performers show an almost symmetric distribution of perceived net strengths, the medium performers show a distribution that is slightly negatively skewed, and the high performers have a distribution that is positively skewed. More of the high performers observations, therefore, have  $I_j$  indices closer to zero, showing that they do not underestimate the threats posed by rivals, nor do they over-exaggerate their own strengths, quite so much as do the medium and low performers.

By direct inspection of these boxplots, one observes that around three-quarters of all firms rate themselves as being as good as, or better than, their rivals; reflecting the fact that the majority of the *Strweak* indices are greater than zero. However, the high performers are less likely to be so dismissive about the relative threats posed by rivals or external influences, with nearly all observations for this group falling below a value of '10'. The medium performers produce indices of up

to 20, and the low performers, of up to about 25, which suggests that they might over-exaggerate or overestimate their own strengths, while at the same time underestimating rivals' threats. On the other hand, the medium and low performers also produce indices as low as about -13 and -15, respectively, which suggests that they can sometimes overestimate, or be extremely fearful of, threats, while at the same time understating their own capabilities. In other words, their self-appraisals and analyses of competitors are somewhat erratic, to say the least, and we can therefore accept proposition 1.

From this overview of the data presented in the boxplots, a further proposition may be developed, as follows:

P<sub>2</sub>: those firms that are most likely to perform better are also most likely to be those with a more realistic appraisal of their strengths, weaknesses, opportunities and threats.

Whilst the descriptive evidence for Propositions P<sub>1</sub> and P<sub>2</sub>, is suggestive, leading to the interpretation that high performers have a more realistic appraisal of their strengths, weaknesses, opportunities and threats, than do low performers, an appeal to a more inferential procedure is desirable. If higher performing firms do indeed have a better appraisal of net strength than do lower performing firms, one would expect a lower variance of the net strength index the higher the performance. This would require that we reject the null hypothesis that the performance groups have the same variances for the net strength index.

An *SPSS* routine was used to compute a one-way ANOVA<sup>4</sup> model with the Levene Test for Homogeneity of Variance, to test the hypothesis described above.

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<sup>4</sup> ANalysis Of VAriance. See, for example, Wonnacott and Wonnacott (1969) *Introductory Statistics*.

In fact the Levene test implies that we cannot reject the null hypothesis<sup>5</sup>, so we do not have enough evidence to suggest that the variances are unequal, and in particular that higher performers have a lower net strength variance.<sup>6</sup> This is not to confirm that the variances *are* equal; as possibly the propositions suggested above would find better support from a larger sample size. As it stands, the data are at least suggestive, in a descriptive sense, of a more realistic appraisal of net strength being a feature of high performance.

The administered questionnaire reveals further details on the 'Environmental Scanning' of the 150 firms in the main sample. The respondent is asked why he became involved in the business in the first place. Twenty-nine per cent of low performers said that the main reason was that it was an alternative to unemployment, compared to 24 per cent of medium and only 10 per cent of high performers, which supports the case study evidence that the low performers were the most likely to have been forced into self-employment. One fifth of the high performers were in it 'to get rich', compared to 10 per cent of medium and 3 per cent of low performers. The low performers were most likely (11 per cent) to want to profit from a hobby, compared to 6 per cent of medium and none of the high performers. Almost one quarter (24 per cent) of low performers thought it was important to be their own boss, compared to one-fifth of high performers. Medium performers seemed to think this was not such a relevant concern (8 per cent). The need for achievement was greatest amongst low (26 per cent) and medium (27 per cent) performers, compared to 20 per cent of high performers.

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<sup>5</sup> The test statistic of .1011 with (2,147) d.f. is very low, and has a .904 prob. value.

<sup>6</sup> In addition, the chi-square test statistics for *Strveak* cross-tabulated by performance [*viz.* Pearson (0.37218), Likelihood Ratio (0.25894) and Mantel-Haenszel test for linear association (0.43087)] imply that we cannot reject the hypothesis of no association.

High performers were the most likely (30 per cent) to have started the business to exploit a new market opportunity, followed by medium (12 per cent) and then low (9 per cent) performers.

High performers were therefore most likely to have come into the business through so-called 'pull' factors, having developed an attractive idea and wishing to exploit what they saw as a profitable niche market. The low performers were more likely to have gone into business because of 'push' factors, such as unemployment, or because of lifestyle-associated benefits, such as being in charge of their own destiny, or gaining some sense of achievement through what they were doing. Medium performers fell some way between the two other groups, with the need for achievement, an alternative to unemployment, making money and exploiting a new niche market all being important to them.

Seventy per cent of high performers said that they would gather trade intelligence on their rivals, compared to 69 per cent of medium and 62 per cent of low performers. On average, high and medium performers would do this every two-and-a-half months, while low performers would do it slightly more often, every two months, probably because their sources of information were more often informal, and they took information as it became available.

Most firms would get some information about their rivals' customers, pricing and product quality. High performers were most likely (100 per cent) to have an idea of their competitors' methods of marketing, compared to 82 per cent and 75 per cent of medium and low performers, respectively, and also of rivals new products (100 per cent), compared to 74 per cent and 84 per cent of medium and low performers, respectively. As regards financial performance, again high performers were more aware (43 per cent) than medium (35 per cent) and low (25 per cent)

performers of competitors' performance. Similarly, high performers were more likely (57 per cent) than medium (47 per cent) and low (32 per cent) performers to have some idea of what share of the market was held by rivals. High and medium performers were equally likely (71 per cent) to know something about their competitors' personnel, compared to 59 per cent of low performers.

By far the most important method of gathering information on rivals was 'through the grapevine', from hearsay or gossip, with almost 100 per cent of all firms saying that this was useful. Newspapers were another common source, used by 71 per cent of high, 68 per cent of medium and 65 per cent of low performers. A similar amount across performance categories used trade associations to gather trade intelligence, with 43 per cent of high, 47 per cent of medium and 35 per cent of low performers saying that they found these helpful. High performers were the most likely (71 per cent) to use trade journals, compared to 62 per cent of medium and 52 per cent of low performers. The least commonly used methods of information retrieval, namely electronic databases, government publications and library sources, were all used by almost one third (29 per cent) of high performers, but by no more than 16 per cent of medium and low performers in any case.

Does the quantity of trade intelligence gathered on rivals have any bearing on the performance of the small owner-managed firm? A new variable, *Intellig*, was calculated to test the theory that a greater knowledge and awareness of rivals' activities will in turn be reflected in the performance of the firm. This variable takes the sum of values for seven possible variables<sup>7</sup> representing information that may be learned about rivals, where each is coded as '1', if the firm does know such

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<sup>7</sup> Market share, new products, product quality, financial performance, customer relations, personnel, marketing methods.



information, and '0', if it does not. The maximum possible value for the variable *Intellig* is, therefore, '7', representing full information, and the minimum value is '0'. The proposition to be explored is as follows:

P<sub>3</sub>: the more information that is gathered on rivals, the better will be the firm's performance.

Figure 5.3a shows the boxplots generated by grouping the quantity of trade intelligence gathered by performance level. Although it appears that each performance group shows a similar dispersion in the intensity of information gathered, ranging from very little (value 'zero') to very much (value '6' or higher), there is a clear increase in the median value as one moves from low, through medium to high performers. For low performers, the median number of items of information gathered on rivals is 3, for the medium performers, it is 4, and for the high performers, it is 5. The data become increasingly negatively skewed, the higher the performance level, which suggests that the level of information which is gathered clusters towards a more intensive use of outside information, the better performing are the firms.

The graph below the boxplots, Figure 5.3b, presents the same information in a slightly different way. The x-axis measures the intensity of information gathering, by *Intellig* which, again, takes a value between 0 and 7. The y-axis shows the mean performance for each level of information-gathering, where '1' represents the lowest performance group, and '3', the highest; mean values between 1 and 3 are interpolated on the graph, with higher values representing higher average performance. After an initial small dip in performance, the graph shows a rising tendency, with higher intensity of information gathering appearing to be correlated with a higher level of firm performance.

QUANTITY OF TRADE INTELLIGENCE GATHERED BY  
PERFORMANCE GROUP

Figure 5.3a

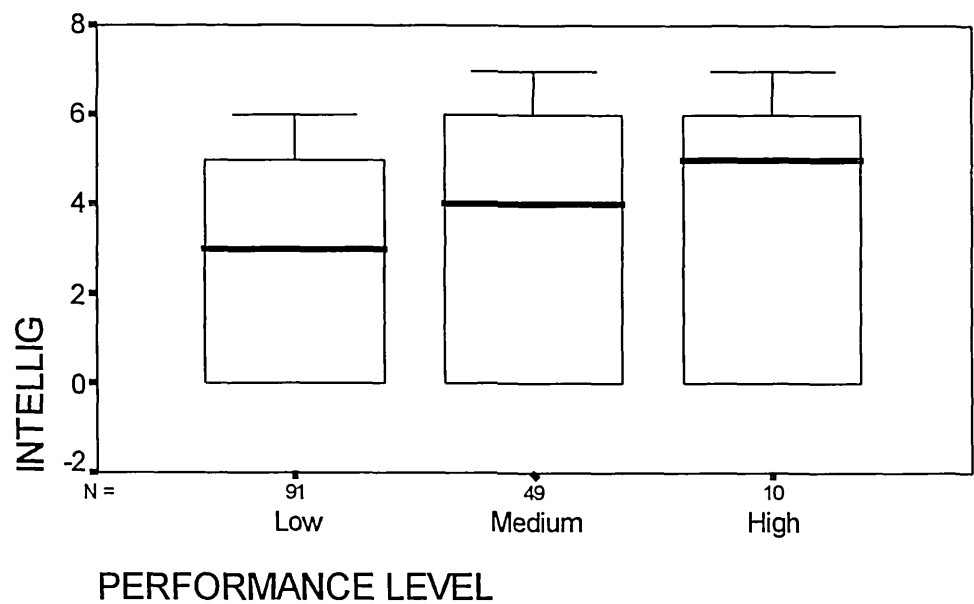
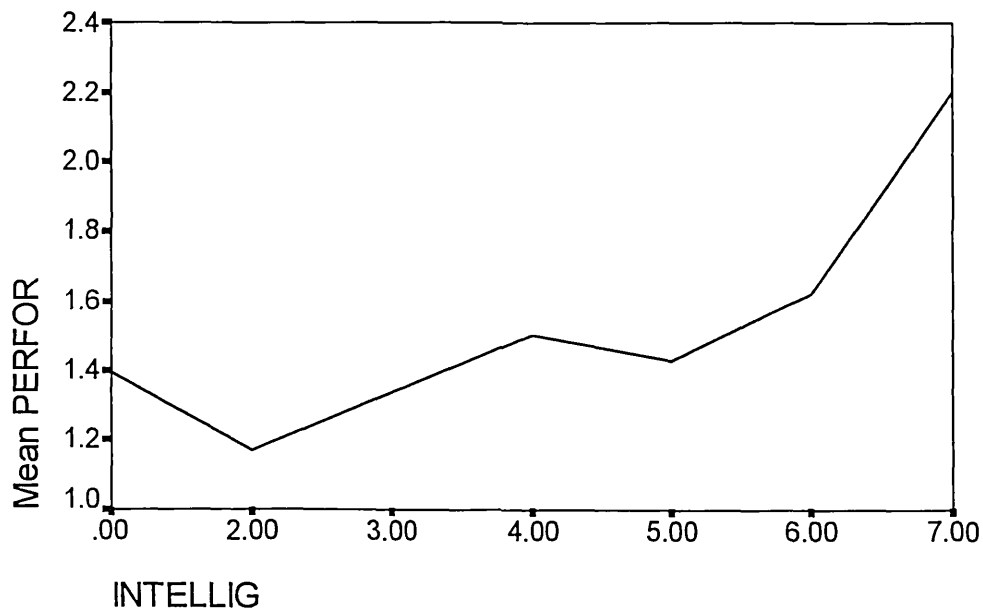


Figure 5.3b



# **CROSS-TABULATION OF QUANTITY OF TRADE INTELLIGENCE GATHERED BY PERFORMANCE GROUP**

**Figure 5.4**

INTELLIG	Count Exp Val Row Pct Col Pct Tot Pct	PERFORM			Row Total
		Low	Medium	High	
.00	35	15	3	53	
	32.2	17.3	3.5	35.3%	
	66.0%	28.3%	5.7%		
	38.5%	30.6%	30.0%		
	23.3%	10.0%	2.0%		
2.00	5	1	0	6	
	3.6	2.0	.4	4.0%	
	83.3%	16.7%	.0%		
	5.5%	2.0%	.0%		
	3.3%	.7%	.0%		
3.00	8	4	0	12	
	7.3	3.9	.8	8.0%	
	66.7%	33.3%	.0%		
	8.8%	8.2%	.0%		
	5.3%	2.7%	.0%		
4.00	11	8	1	20	
	12.1	6.5	1.3	13.3%	
	55.0%	40.0%	5.0%		
	12.1%	16.3%	10.0%		
	7.3%	5.3%	.7%		
5.00	22	8	3	33	
	20.0	10.8	2.2	22.0%	
	66.7%	24.2%	9.1%		
	24.2%	16.3%	30.0%		
	14.7%	5.3%	2.0%		
6.00	10	9	2	21	
	12.7	6.9	1.4	14.0%	
	47.6%	42.9%	9.5%		
	11.0%	18.4%	20.0%		
	6.7%	6.0%	1.3%		
7.00	0	4	1	5	
	3.0	1.6	.3	3.3%	
	.0%	80.0%	20.0%		
	.0%	8.2%	10.0%		
	.0%	2.7%	.7%		
Column	91	49	10	150	
Total	60.7%	32.7%	6.7%	100.0%	
Chi-Square		Value		DF	Significance
-----		-----		----	-----
Pearson		13.92484		12	.30553
Likelihood Ratio		16.73254		12	.15994
Mantel-Haenszel test for linear association		3.55890		1	.05923
Minimum Expected Frequency - .333					
Cells with Expected Frequency < 5 - 12 OF 21 ( 57.1%)					

Developing this point further, Figure 5.4 presents the data for *Intellig*, cross-tabulated by performance level, and shows in more detail how each group is divided. It confirms the inferences made from an overview of Figure 5.3. First of all, a greater percentage of low performers (38.5%) than medium (30.6%) and high performers (30.0%) gather no information at all on rivals, either through inclination, or perhaps because of time constraints. Of those who do gather information, low performers are the most likely to gather only two (5.5%) or three (8.8%) pieces of information, compared to medium performers (2.0% and 8.2%, respectively) and high performers (0% in each case). A difference emerges when we move to four items of information gathered, with more medium performers (16.3%) than both low (12.1%) and high (10.0%) performers in this group. And at the level of five items of information gathered, high performers (30.0%) overtake both medium (16.3%) and low (24.2%) performers. Above this level, the amount of information gathered accords with the firms' rankings by performance. So, higher performers are more likely to gather six (20.0%) or seven (10%) items of information than both medium (18.4% and 8.2%, respectively) and low (11.0% and 0.0%, respectively) performers.

The general pattern seems to be that those firms who know more about their rivals also tend to be those who perform better. Put another way, an owner-manager who has a greater awareness of the potential threats posed by rivals is better able to position himself and his firm in the markets in such a way that he is able to exploit opportunities and defend against attacks from competitors. Although the descriptive evidence is quite persuasive, the inferential evidence is equivocal. Pearson and Likelihood Ratio tests produce statistics which just fail to fall in the critical region. The Mantel-Haenszel test for linear association provides

a  $\chi^2$  statistic which is certainly significant at the 10% level, and almost significant at the 5% level. One therefore has modest inferential evidence for rejecting the hypothesis of no association between the pursuit of trade intelligence and small firm performance. Given the strong association between performance and trade intelligence suggested by the boxplots and graphs, it seems reasonable to argue that greater knowledge of the environment in which the firm operates will enable the owner-manager to make more informed, and therefore better, decisions, leading in turn to enhanced performance [*cf.* Madu and Kuei (1993)].

Overall, in terms of environmental scanning, the picture which emerges is of high performers who are proactive in gathering trade intelligence on their rivals on a regular basis. When they decide to seek out information, they know which sources to use and do so systematically, being effective in gathering the knowledge they seek. Medium performers are not as likely to be quite so focused, and low performers even less so, often learning what their rivals are up to through informal conversations or gossip. This evidence supports the conclusions reached through the case study analysis of high and medium performers who are found to be more aware of the market in which they operate, than low performers, who often pay very little attention to the activities of their competitors.

### **5.3 Strategy Formulation**

#### ***(i) Mission***

The mission of a business is a statement of what the business stands for, what it hopes to achieve, its directions, aims and ambitions [*cf.* David (1989)]. Business plans can perhaps help to clarify the thoughts the owner-manager with respect to the mission of the business. This plan might contain, for example, a market

analysis, plans for marketing products, financial targets and plant or staffing requirements, as well as milestones and timetables for achieving their goals. It can provide a useful benchmark against which to judge actual performance.

### *High Performers*

The existence and use of business plans amongst the firms in the case study analysis is summarised in Table 5.3. Of the three high performance case studies, two had a formal, written business plan, and one had used a plan previously. The latter (*Case L*) was “sceptical” about such plans, saying that he found it difficult to project what the future might hold. He was unable to see the point in spending time predicting what he *hoped* might happen. This echoes earlier findings that “if the ... owner does not perceive that his/her company is better off for having planned, he/she will no longer allocate resources to planning” [Shuman and Seeger (1986, p.12)]. However, the other two both had detailed formal plans, and had updated them when required, for expansion, moving premises, or reformulating budgets, lending support to the view that “high-growth firms are strongly committed to frequent strategic planning sessions” [Baker *et al* (1993, p.87)]. These were long-term plans, projecting several years into the future.

*Case C* specifically mentioned having a “strategic vision”, as well as a “mission”, the former being to keep the business focused, and the latter “to please our customers”; whereas both *Cases K* and *L* wanted to “make as much money as possible” and to “increase turnover year by year”, respectively. Their responses support Johnson and Scholes (1984, p.156) notion that a mission “may be an unwritten concept ... a written ‘creed’ ... [or] a generally accepted view of what

## EXISTENCE AND USE OF BUSINESS PLANS

Table 5.3

	Firm has a plan	Plan is Formal	Plan used in business	Plans is 'in head'
<b>High Performers</b>				
CASE C	✓	✓	✓	
CASE K	✓	✓	✓	
CASE L	✗			
<b>Medium Performers</b>				
CASE B	✓	✓	✓	
CASE G	✓			✓
CASE H	✓	✓	✓	
CASE I	✓	✓	✓	
CASE J	✓	✓		
CASE N	✗			
<b>Low Performers</b>				
CASE A	✗			
CASE D	✓			✓
CASE E	✓	✓		
CASE F	✓			✓
CASE M	✓			✓
CASE O	✓			✓
CASE P	✓	✓		
CASE Q	✓	✓		

Note: ✓ - yes  
✗ - no

the firm is about that is accepted by most of those working in the company”.

### *Medium Performers*

Amongst the six medium performers, four had formal, written plans, one (*Case G*) a plan ‘in their head’ and one (*Case N*) had no plan at all. *Case G*’s respondent said that his business was “forever striving to make money”, and preferred to deal with shorter-term goals, say of up to twelve months, than to aim to reach longer-term targets. *Case J* had a formal plan, which was considered “maybe once a year” in consultation with the accountant. The remaining three used their plans mainly to analyse markets, staff levels and premises, but they also typically included financial forecasts.

*Case G* was the only medium performer to have a “company statement”, which covered the desire for a good product quality and competitive prices. The remainder also expressed a wish to provide a good product and service, which would eventually lead to the development of a successful business. *Case B* wanted “to build up a business over the next ten or fifteen years that can become a saleable item”; *Case G*, “to deliver the highest quality of service that both meets and exceeds customer expectations”; *Case H*, “to develop a quality and high value product, which will let us grow to be a big and successful business”; *Case I*, “to be as big and as good as we can”; *Case J*, “to let women who come into my shop go out feeling a million dollars, and to make a profit”; and *Case N*, “to put a stylish and affordable product on the market, and to earn ourselves a good livelihood while doing so”.



### *Low Performers*

Three of the eight low performers had a formal, written business plan [cf. Table 5.3], four, a plan ‘in their heads’ and one (*Case A*) had no plan, because the respondent found it “hard to sit down and make a plan, and stick to that plan” [cf. Welsh and White (1981)]. Of those with an informal and unwritten idea, the thoughts were typically of seeking out new markets. For example, *Case D* hoped to “take all the ideas and put them into Glasgow”; *Case M* was considering “branching into different sectors”; and *Case O* had “a marketing plan in my head”. *Case F* claimed only to “come up with brilliant ideas”, but was not specific about what these ideas were. Of the three low performers with a formal business plan, there was little evidence to suggest that they were used to help in the actual running of the business: *Case E* said “I know basically what’s in it”; *Case P*, that “projected figures are only ‘pie in the sky’”; and *Case Q*, that it was “three years since we wrote it and we haven’t looked at it since”.

Personal issues were prevalent amongst the missions of the low performers, with *Case A* desiring “a secure future for my family”; *Case E*, “a decent living”; *Case M*, “a good name and respectability in the market”; *Case O*, “to make a lot of money ... take it easy ... and job satisfaction”; *Case P*, “to keep me in a reasonable livelihood and leave my son something to follow on with”; and *Case O*, “to survive till we retire”. The other two wanted “to provide a quality product and service” (*Case D*) and to be the top of their profession in Scotland (*Case F*).

### *Conclusions*

The characteristics of each performance group, in terms of their firm’s mission, can be quite neatly summarised as follows. The high performers had a clear idea of the

direction they wished the business to follow: two used formal business plans of up to five years time horizon, and the other thought or planned ahead at least six months, having attained the targets set by his original two-year plan. This evidence thus supports the belief that “top management should be proactive in initiating planning so that its fullest value can be achieved” [Aram and Cowen (1990, p.65)]. These were also more likely to suggest that ‘making money’ was the major mission of the business. The medium performers, too, very often had business plans, though were likely to have shorter planning horizons. Their missions typically mentioned the product quality or customer service as being of prime concern, leading eventually to the development of a profitable business.

The low performers were less likely to have a formal plan, or to use it if one existed which, to some extent, refutes Mintzberg’s (1994, p.107) suggestion that “the most successful strategies are visions, not plans”. It was very often formulated simply for the firm to qualify for start-up funding support [*cf.* Baker *et al* (1993)], and had often been recommended as a course of action by the local Enterprise Trust, rather than coming from the owner-manager’s own initiative. Low performers were most likely to suggest that the ‘mission’ of the business was personal, or simply to provide a living, than anything else. Compare this with the work of David (1989, p.95) who suggests that “developing a mission statement is often overlooked in [some] firms as managers rush too quickly to establish targets and implement strategies without spending sufficient time in clarifying their strategies”.

Data from the administered questionnaire support the popularity of business plans. Eighty per cent of high performers had one, 25 per cent of which were both formal and written; 92 per cent of medium performers had a plan, 18 per cent of

these being formal; and 89 per cent of low performers had plans, with 22 per cent being formal. However, the most telling result comes from the question which asks the time horizons over which respondents look, when considering the impact of new decisions. While both medium and low performers would think, on average, 14 to 15 months in advance, the high performers would consider outcomes on an average of up to 31 months, or two-and-a-half years ahead; twice that of the lesser-performing business [*cf.* Ansoff (1965)].

This variable (*Impact*), gives a better impression of planning procedures in small firms, as it asks specifically about planning time horizons [*cf.* Ansoff (1965)], as opposed to simply asking whether or not a business has a plan. In fact, in Reid and Smith (1996), the authors find, for the same sample of firms, that the variable *Impact* had one of the strongest positive effects on performance of any variable, and that a firm with an owner-manager who thought far ahead was much more likely to perform well than one with a leader who had only short-term vision. The actual existence of a business plan is not, therefore, the most important consideration. Instead, performance appears to rely to some degree on the actual process and use of on-going formal planning [*cf.* Thurston (1983); Baker *et al* (1993)].

## **(ii) Objectives**

An analysis of a firm's objectives will aim to discover what the business is trying to achieve and what are its long-term goals [*cf.* Aram and Cowen (1990)]. Given that almost all (97 per cent) of the firms in the sample said that they hoped or expected their businesses to grow over the following years, further insight may thus be gleaned by asking what the owner-manager means, or understands, by growth;

what, in fact, is growth to his or her business? An additional and interesting line of questioning will then examine the reasons for wanting to achieve the identified objectives.

### *High Performers*

The three high performers had all specified a main aim as being 'long-term profit', with *Case K* also seeking a 'high rate of return', and *Case L* an 'increased market share'. Growth was clearly identified as "an increase in the number of branches" (*Case C*); "higher profile ... more clients and more business ... more money, and respect" (*Case K*); and "increased turnover and profitability ... an increase in the client base". All of the high performers hoped, therefore, to augment the number of customers with whom they dealt, as well as improving sales and making higher profits. These firms could be classed under Stanworth and Currans' (1986, p.88) "manager identity", where "the entrepreneurial latent social identity centres on meanings and goals concerned with the recognition ... of managerial excellence [and where] other goals ... are security and a concern to ensure that the entrepreneur's children will eventually receive the benefits of his enterprise".

Although personal reasons were important to these businesses - "I want to be comfortable financially and provide for the family" (*Case C*), and "I want to have a good quality of life" (*Case K*) - it was also apparent that the higher performers enjoyed the satisfaction they gained by providing employment and a living for their staff: "The company will provide an opportunity for the employees to develop" (*Case C*); and "I like to help employment" (*Case L*). Their objectives are thus consistent with Ansoff's (1965, p.61) recognising "both institutional influences and personal objectives as affecting strategic decisions in the firm", where institutional

attitudes cover such aspects as job security for key personnel and promotion prospects for staff.

### *Medium Performers*

Four of the medium performers sought 'long-term profit' as a major goal, with one (*Case B*) striving for a 'high rate of return' and one (*Case N*) "to achieve profitability". The definition of growth varied across firms, with *Case B* wanting to move into different areas that provided a higher rate of return, and *Case G* aiming to "build the tiers" of management, by taking on more senior staff. The other four, however, all defined growth in terms of an increase in sales or customer base: *Case H* sought an "increased volume of sales, profits and the value of the company"; *Case I*, "more money, in terms of turnover and profit"; *Case J*, "more customers, more money and a salary for me"; and *Case N*, "a doubling of the number of accounts we have" with customers.

The reasons for wishing to attain the goals mentioned above varied quite markedly from one business to another. *Case B* wanted to have the time to "stand back and see where we want to be in the long term", which would be facilitated through growth and the employment of more staff. *Case N* thought that an increased client list would "even out the flow of business instead of having peaks and troughs". Two cases were chasing their goals for pecuniary benefits: "I want my money back at the end of the day" (*Case G*); and "to be wealthy" (*Case I*). And the remaining two cases thought similarly that "if you're going to run a business, [you should] run the best business you can" (*Case H*); and that "there's no point in doing it unless you can achieve [your goals]" (*Case J*). Their ambitions are consistent with those of Stanworth and Currans' (1986, p.88)

“classical entrepreneur”, where “earnings and profit become a core component in the entrepreneur’s definition of his role and hence in the way he acts out his role”.

### *Low Performers*

Half of the low performers said that ‘survival’ was still the major objective, with two of these hoping eventually for ‘long-term profit’, and two for ‘increased sales’. The others were all seeking ‘growth’, leading to ‘long-term profit’. Five of these cases defined growth in monetary terms: to *Case D* it would mean “a pure rise in profit”; to *Case E*, “to run at a profit, and increase sales”; to *Case F*, “to make some money”; to *Case M*, “increased turnover”; and to *Case Q*, growth occurs when “turnover improves”. *Case A* wanted to widen its product range, enabling it therefore to “exploit more customers”; and *Case O* defined growth similarly as “getting more work”. Only two of the low performers thought of growth as an increase in staff; *Case M*, who had taken on two further employees; and *Case P*, who wanted “to increase permanent staff and have a girl in the office to do the books”.

The vast majority of the low performers sought their goals for mainly personal reasons, taking advantage of “the opportunity to take into account their own goals when corporate objectives are set” [Thurston (1983, p.176)]. *Case A* wanted “to give people jobs and have more security”; *Case D*, “satisfaction from seeing something I’ve created succeed”; *Case E*, “to live ... and to pay the mortgage”; *Case F*, “to get something back ... we have to show something for all this extra outlay”; *Case O*, to “make a living at what I really want to do”; *Case P*, to “get ... costs in relation to your sales figure ... so your salary increases too”; and *Case Q*, because they “want to be successful, and don’t want to be a failure”. *Case M*, the

only one of the group to suggest a non-personal ambition, said that they were hoping for extra staff to enable them to “diversify into other things”, but admitted that, in any case, “we don’t want to be too big”. These firms correspond most closely to the “artisan identity” of Stanworth and Curran (1986, p.87) where “the entrepreneurial role centres around intrinsic satisfactions of which the most important are personal autonomy at work, being able to pick the persons you work with, status within the work-place and satisfaction at producing a quality product backed with personal service”.

### *Conclusions*

A summary of the objectives of each performance group suggests the following grouping by characteristics. First, the high performers tend to specify longer-term goals such as ‘long-term profit’ or a ‘high rate of return’. These were amongst the most rational economic objectives from which the respondent could choose, and are consistent with Porter’s (1985) advocacy for the pursuit of *sustained* profitability, and Ansoff’s (1965, p.41) assumption that “the primary economic objective is to optimize the long-term rate of return on the equity employed by the firm”. They all sought growth, and were able to define it in relation to both internal and external factors; as an increase in the firm’s product range or outlets, a greater client base, higher turnover and, especially, improved profitability. These firms mentioned a desire to generate employment for others, as well as to provide a good living for themselves and for their families.

The objectives of the medium performers differed, although ‘long-term profit’ was, as with the high performers, a popular choice. These businesses defined growth in varying ways, which ranged from an extension of product range, through

the employment of more staff, to an increase in sales and profits, or greater size of client base. No one clear reason stood out from any other for seeking goals of growth and profitability. There were both personal and purely professional reasons for aiming to achieve goals, but these reasons were not generally as clear, nor as obviously grouped, as those of the higher performers.

The low performers typically had a shorter-term view of their goals, with 'survival' being a common response, followed by 'increased sales' and, hopefully, 'long-term profit'. They spent more time on the operational considerations of running their business, often to the neglect of strategic issues [*cf.* Peiser and Wooten (1983)]. Most thought that growth would mean 'more money', although others wanted 'more work' and 'more staff'. Objectives were mainly personal, and intended to provide an income for the owner-manager, and in some cases, for their staff.

### *Supporting Evidence*

The administered questionnaire provides further details about the main aims of the business. The evidence suggests that low performers were the most likely group to specify a main aim as being 'survival' (23 per cent), compared to only 8 per cent of medium performers, and none of the high performers. About one third of each performance group sought 'long-term profit' as a major goal, and between one-fifth and one-quarter of each group specifically identified 'growth' as their main aim. The higher performers were more likely (20 per cent) than the others to identify 'increased market share' as being their main aim, as compared to 16 per cent of medium and 10 per cent of low performers. Most interestingly, though, was the fact that 30 per cent of high performers sought, as their main objective, a



‘high rate of return’, as compared to only 12 per cent of medium and 4 per cent of low performers. This suggests a greater flexibility, as those seeking the highest rate of return possible will be more likely to go where they can make the most money, even if it involves changing tack completely. See Reid and Smith (1996), who identify the latter goal of high rate of return as having a positively significant effect upon performance.

### *(iii) Strategies*

This section of the questionnaire concentrates on the strategies of the business, looking at how it aims to achieve its objectives; how it will beat the competition. It considers, for example, the actions taken to protect the firm from competitors, or to attract new customers away from rivals to assist in achieving their objective of growth. The decision-making process within the firm is also discussed, along with the use of information technology and its importance to the business in assisting both operational and strategic functions.

### *High Performers*

Table 5.4 summarises the responses to the question ‘do you consider a menu of strategic options?’ [*cf.* Johnson and Scholes’ (1984, p.167) ‘Strategic Choice’]. Of the three high performers interviewed, two said that they would *not* consider a menu or list of strategic options: *Case C* explained that this was because his business was “focused” and that “the strategic aim is always there”. On the other hand, *Case K would* consider various options, deciding between them by “feeling out the market and talking to people”. Long-term decisions were dependent, to

**RESPONSES TO QUESTION:  
'DO YOU CONSIDER A MENU OF STRATEGIC OPTIONS?'**

**Table 5.4**

	YES	NO
<b>High Performers</b>		
CASE C		✓
CASE K	✓	
CASE L		✓
<b>Medium Performers</b>		
CASE B	✓	
CASE G		✓
CASE H	✓	
CASE I	✓	
CASE J	✓	
CASE N	✓	
<b>Low Performers</b>		
CASE A	✓	
CASE D	✓	
CASE E		✓
CASE F	✓	
CASE M	✓	
CASE O	✓	
CASE P	✓	
CASE Q		✓

some extent, on the financial implications of that decision. For example, the decision *when* to grow “is dependent upon the funds being available” (*Case C*); “if a potential client had no credit risk insurance, we would not deal with the guy” (*Case K*); but, according to *Case L*, “the financial implications are irrelevant”, and decisions were more likely to be “based on what’s available in the market”.

Long-term plans typically were not discussed on a regular and formal basis, according to these respondents. For example, *Case C* said that they were “more driven by me at this stage”, although he did “consult people in and out of the business”; *Case K* had “regular sales meetings”, but would more often “deal with things on a day-to-day basis”; and *Case L* said that he would not generally formulate in a structured fashion long-term plans, although he did think up to six months ahead when making decisions.

All three high performers used advertising, either to protect their business from the threat of new or existing competitors, or to attract new clients away from their rivals: “We advertise regularly and often - that’s a real barrier to entry” (*Case C*); and by “maintaining market presence through sales calls ... making sure we’re visible” (*Case K*). *Case C* also thought that his unique selling point was important: “We are differentiated”; as did *Case L*, who believed you should “ensure you keep the service going above and beyond what they [i.e. rivals] offer”, and maintain “competitiveness” by lowering prices if rivals try to undercut [*cf.* Porter (1980, 1985)].

Each high performer thought that information technology was very important to the running of their business, for reasons which included speed and the facilitation of communications: “it gives us advantages on both our larger and smaller competitors [and] gives us opportunity as a sales tool” (*Case C*); “it gives you

sales on a daily basis and allows you to make decisions” (*Case K*); and “we use it in the day-to-day running of our business ... things change rapidly” (*Case L*) [*cf.* Porter and Millar (1991)].

The belief of importance of IT to each firm considered under this case study analysis is summarised in Table 5.5. Information technology was used for different activities, including operational activities such as accounting, administration and keeping track of buyers and suppliers. In addition, it was used strategically, to differentiate the firm:: “we try and send a letter to our customers to say thank you ... it’s something our larger competitors can’t do” (*Case C*) [*cf.* Porter and Millar (1991)]; *Case K* said that “we are going to use it for stock control”; *Case L*, that “we use pagers and mobile phones to get in touch with workers on site”.

The high performers all seemed fairly clear about the directions they wanted their business to take, and so the question of deciding between different courses of action did not necessarily arise. Finance was an important consideration when deciding whether or not to accept a new idea, but was not the sole overriding factor; market conditions were also relevant. Advertising and maintaining a competitive edge were thought to be crucial to the firms for retaining and enhancing their customer base; and information technology was implemented and adapted as needed, to help in this process. All respondents were aware of its extreme importance, because of the advantages it offered in terms of speed, communications and differentiation.

# SUMMARY OF OWNER-MANAGER'S BELIEF OF IMPORTANCE OF I.T. TO HIS FIRM

Table 5.5

		IMPORTANCE OF I.T.		
		Scarcely	Moderately	Very
<b>High Performers</b>				
	CASE C			✓
	CASE K			✓
	CASE L			✓
<b>Medium Performers</b>				
	CASE B			✓
	CASE G			✓
	CASE H			✓
	CASE I			✓
	CASE J		✓	
	CASE N			✓
<b>Low Performers</b>				
	CASE A	✓		
	CASE D	✓		
	CASE E			✓
	CASE F			✓
	CASE M			✓
	CASE O	✓		
	CASE P	✓		
	CASE Q			✓

Note: ✓ - yes

### *Medium Performers*

Four out of the six medium performers said that they *would* consider a menu of strategic options [cf. Table 5.4]. *Case B* would “think of an idea and narrow it down to (1) ideas, (2) potentials and (3) realities”, using outside advice to assist them in quantifying and qualifying the possible outcomes; *Case H* would “look at the return on investment on everything”; *Case I* said that “we use computers a lot, and have done a business plan” for the proposed expansion; and *Case N* would decide upon which actions to follow based on a subjective assessment of their “viability”. *Case G* admitted that, “if you’re new to a business you would do that [i.e. consider a menu of options]”, but explained that “as you get more into the business, or are naturally good at it, you go through things in your mind”.

Decisions were most likely to be based on market information in the medium performing firms: *Case B* based long-term decisions on management’s specialist knowledge, built up over many years in the trade; *Case G* had his “finger on the pulse” and would “*never* look at finance”, preferring instead to rely on “gut feeling”; *Case H* relied on “market research, market information of other companies and market information on the global market in general”; *Case I* on keeping “in the know” about what potential customers would be spending in the future; and *Case N* on “a mixture of things”. Only *Case J* would base decisions purely on the company accounts.

Two of the medium performing firms were unlikely to make formal plans; *Case J* and *Case N*, who would “bounce my ideas off other staff I have”. *Case G* was slightly more formal and would “speak to the accountant once a year”, but would also have quarterly meetings on major goals. *Case B* had “brainstorming meetings every six months”, or whenever a new opportunity would arise; *Case H* had

“regular staff, management and Board meetings”; and *Case I* had “regular Board meetings and strategy reviews.

The actions taken by medium performers to protect their customer base varied from firm to firm; *Case B* kept themselves “aware” of competition and where it was operating; as did *Case J*. *Case I* relied on their quality: “we are constantly looking over our shoulders to update and improve our quality”; and *Case N* relied on his new products and developments: “you’ve got to keep on innovating”. *Case H* hoped to encourage customers to stay with them, partly “through P.R.”, whereas *Case G* thought that “maintaining private ownership” gave his company an “edge”, allowing him to keep his accounts private.

Two of the medium performers were proactive in trying to attract new clients: “we use teletext ... and direct mail” (*Case B*); and “we show what our company can do through presentations” (*Case H*). However, the remainder were fairly relaxed about getting new clients: “the customers tend to come to us through recommendation” (*Case G*); “word of mouth and recommendations are important” (*Case I*); “I rest on my reputation and word of mouth” (*Case J*); and “I’m not really trying to [i.e. attract customers away from rivals]” (*Case N*).

Five medium performers thought that information technology was important to their business [*cf.* Table 5.5]. Advantages identified included the speed of information gathering, savings on labour, and cheap and accurate communications: *Case B* found it invaluable “because of the number of outlets we have to deal with”; *Case G* thought it was both a “labour-saving option” and helped to maintain the “customer ‘feel-good’ factor”; *Case H* appreciated “the speed we can turn around a budget and feed in real information”; *Case I* believed that “if you keep up-to-date with technology, there are new ways always on the market-place”; and

*Case N* liked information technology because “it is quick and inexpensive and accurate across distance”. *Case J* was not currently a great user of IT, but hoped to change this situation in the near future because she thought it would “improve the way I do business with suppliers, as you can communicate faster and get a quicker response”.

Information technology was integrated into the medium performing businesses in a variety of ways. *Case B* used it mainly to obtain “immediate information” from on-line databases; *Case G*, for “contact management, accounting and administration”; *Case H* said that “everything is on the PC”; *Case I* had implemented a sophisticated CAD<sup>8</sup> technology system; and *Case N* used IT to “fax orders and sketches” to the USA. *Case J*, the lesser user of technology, had a PC at home, on which were held her accounts, and she used her phone for “stock enquiries, ordering, and details of forthcoming events such as fashion shows and trade fairs”.

Two-thirds of the medium performers would generate a list of options before deciding on the specific direction they wanted their business to follow, using often quite technical methods to appraise and decide between them. Perhaps this distinguishes them from the risk-taking high performers, in that they have a slightly less focused vision, and are less confident to follow their instincts, instead taking the more risk-averse route of carefully evaluating different options [*cf.* Bhidé (1994)]. This group of firms based decisions mainly on market information, with financial implications typically being less important. The scale of formality in making new plans, amongst medium performers, ranged from relatively informal

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<sup>8</sup> Computer Aided Design.



discussions to regular meetings with the Board of Directors. They relied on their quality and an awareness of competition to retain the customers they already had, but were not generally so good at seeking new clients; reputation and word of mouth were the prime methods of attracting new business. Information technology was used for the transmission and storage of information, often in quite specialised ways.

### *Low Performers*

Six out of eight low performers said that they *would* consider a list of strategic options [*cf.* Table 5.4]. Of the two that would *not*, one (*Case Q*) said simply that there were only “three things we can do”, and they were already doing them. *Case A*, being a partnership, had two very different personalities, generating many possible options: “we think opposites all the time; we chat about it”. *Case D* would think about options “over and over in my head”, whilst also carrying out “comprehensive financial forecasts”; *Case F* had “considered a lot of things”, but the lack of money and suitable opportunity had stopped the implementation of new ideas; *Case M* used computer software packages to evaluate alternatives; and *Case P* would “throw a lot of ideas at people and see which ones they accept”.

Long-term decisions were often based on the financial implications of those decisions. *Case A* used experience from the past to help them decide, saying “financially, we look back”; *Case D* would tend to use a combination of “financial forecasting and gut feeling”; *Case E* said it would depend simply on “finance”; and *Case M* would look at “monthly management accounts, and use everything”. The other half of the low performers relied on ‘soft’ rather than ‘hard’ information when making major new decisions, which contradicts Mintzberg’s (1994, p.111)

suggestion that “*the most effective managers* rely on some of the softest forms of information, including gossip, hearsay, and various other intangible scraps of information” [italics added]. *Case F* used a project conducted by a local university student, which examined the local market and advertising requirements of the company; *Case O* would make “my own decisions”, based on the occasional word through hearsay; *Case P* claimed not to be able to make long-term decisions; and *Case Q* had based one major decision on the benefits it offered to the firm, in terms of saving time.

Amongst the low performers, long-term plans were nearly always developed on a very informal basis. *Case A* had ideas “in the back of my head”; *Case D* would “mostly knock ideas about with people I trust”; *Case E* would “discuss it with my employee”; *Case F* had “informal discussions”; *Case M* said that “every day, we talk about something”; *Case O* would “test the tone of the market and decide myself”; *Case P* would “sit and have a blether”; and *Case Q* would “sit and speak about things”.

When trying to ensure customer loyalty to their firm, the low performers mentioned that quality, advertising and good customer relations all played an important role: “we make sure our quality is up to standard, the work is done within a reasonable time, we are not overspending and are keeping our prices at a reasonable level” (*Case A*); “all you can do is try and advertise and keep it in peoples’ minds” (*Case D*); *Case E* relied on “the service I give them”; *Case M* on “our name and our history”; and *Case O* on having “good customer relations”. Three of this group of firms thought that there was nothing that could be done to retain customers if they wanted to go elsewhere: “there’s not that much we can do” and cutting prices “doesn’t work” (*Case F*); “you can’t really; it’s down to the

personal relationship with your client” (*Case P*) and “we don’t take any action; there’s nothing much we can do” (*Case Q*).

Again, in an effort to attract new custom, the low performers would often rely on quality and advertising: *Case D* specified “the quality of our service and the uniqueness of the activities we offer”; *Case M* relied on “advertising, word of mouth, then eventually our expertise”; and *Case Q* on “the quality of our work” and occasional advertising. Of the others, very few made a consistent effort to attract new clients: *Case E* said that “now and again I have offers”; and *Case F* would “give people 20 per cent off if we think it will mean repeat business”; but *Case A* admitted “I don’t know why they come to us; they just do”; *Case O* said that “I don’t like stepping on peoples’ toes; I don’t like conflict”; and *Case P* that “we don’t deliberately try” to get new customers.

Half of the low performers thought that information technology was scarcely important to their business [*cf.* Table 5.5], whilst the other half considered it to be very important. Of those who made little use of IT, one (*Case A*) said that they “seemed to cope with our heads” and, in any case, “we don’t know what’s available to us”; *Case D* said his “industry as a whole is quite slow in moving into IT”; *Case O*, the artist, explained that “the line of work is basically pencils and pens”; and *Case P* said that “if I’m looking for something for a specific purpose, I read a lot of magazines and send away for information on the products”.

Those who used IT recognised its importance in assisting fast communications and the transfer of information: “speed is important” (*Case E*); “it gives you instant knowledge” (*Case M*); and “the trade is changing all the time; it’s very fast-moving” (*Case Q*). Information technology within these firms was not typically as advanced as in the higher performing groups, but it was used for storing and

transmitting information: “I use the phone and fax for telesales and customer contacts and queries” (*Case E*); “we have a computer database and we use it for estimating”, but “we use it as a word processor more than anything else” (*Case F*); “we fax surveys through all the time; ten years ago it didn’t happen” (*Case M*); but *Case Q* used IT “for producing the product rather than administration”.

Low performers were even more likely than the other firms to generate a menu of strategic options; perhaps because they were less likely to have a focused idea of what they hope to achieve from their business. Decisions were made by half of the firms on ‘hard’ facts, often financial information; and by the other half on ‘soft’ information, of things heard ‘through the grapevine’. Plans were typically developed on an informal, often ad hoc basis, through chats or discussions amongst the staff. Low performers hoped that their quality and advertising would help them to retain customers, but were less likely to seek actively new or additional business, relying instead upon referrals and word of mouth. Information technology in these firms was not highly sophisticated; very often it consisted of mainly fax and telephone communications. However, most recognised the speed and accuracy it allowed were beneficial, even if they were unaware of the various other facilities available, or applications for which it could be used.

### *Conclusions*

Summarising the firms in terms of their strategies, the high performers, first of all, appeared to have the clearest focus, as regards where they wanted the business to go. They tended to adopt an ‘all-or-nothing’ approach, and appeared to be less risk-averse or more risk-loving than the lower performers, supporting Bhidé’s (1994, p.160) assumption that “by taking a personal risk, the entrepreneur

convinces other people that the venture *will* succeed”. Witness their decision to choose a plan and stick to it, or to disregard the financial costs of a new strategy, without spending too much time on deliberation. An analysis of finance and market conditions helped them in developing new plans, but these were not generally too tightly formalised, and depended very much on the owner-manager’s drive. The high performers all actively sought new business, and used advertising and differentiation to both keep old and attract new customers. Information technology was integrated into all of these firms, and used for accounting, administration, stock control and communications, amongst other things.

The medium performing firms were slightly less well focused than the higher performers, generating options rather than creating and following a predetermined plan. They used various evaluation methods to choose between options and seemed to base most of their decisions on financial followed by market information, being of a more risk averse nature than the high performers (*viz.* their tendency to perform detailed analysis of options before making a choice). Plan formulation was often highly structured, and based on the outcomes of regular meetings. Medium performers were less active in trying to seek and retain new customers, but some would use advertising to help in this. High technology was not so extensively used as in high performing firms, but its importance was recognised by the majority.

Low performers appeared to be even less well-focused than the others, with most choosing to develop optional strategies or courses of action. They seemed to be searching for a plan, rather than having one already in mind. These firms are typical of the “equivocators” in Carter *et al* (1994, p.31) for whom “uncertainty seemingly characterizes strategy formulation”, and who are compared to Porter’s

(1985) classification of firms that are “stuck in the middle”. Informal discussions formed the main arena for generating new ideas, which were often based on ‘soft’ information or historical data, rather than projected or expected outcomes. They were most unlikely to seek new customers, often appearing to lack the ruthlessness and strong nerves required if a small firm is to gain business in a tough competitive environment. Information-technology was not greatly used, and respondents often showed a lack of awareness as to what use it could be put in their own firm.

### *Supporting Evidence*

From the data generated by the administered questionnaire, the evidence on planning, discussed above, is supported. Twenty-nine per cent of low performers would formulate business plans with the help of others in the company, represented in the case analysis by the frequent informal discussions the owner-managers would have with either fellow directors, or with staff. In descending order of importance, 20 per cent of the medium performers, and 17 per cent of high performers would similarly formulate plans through consultation with others in the business. Equally revealing is the fact that only one-third of high performers would seek outside help in formulating plans [*cf.* Baker *et al* (1993)], compared with three-quarters of the medium performers and two-thirds of the low performers. This suggests that high performers are both more able, and have the capability to work on their own initiative, or that their so-called ‘core competencies’ or ‘distinctive capabilities’ are higher [*cf.* Kay (1993); Bakker *et al* (1994); Prahalad and Hamel (1990)]. It also supports the evidence that lower performing firms are most likely to have formulated business plans following the suggestion of, say, their accountant or local enterprise trust. Interestingly, one third of the high performers were likely to

have consulted family or friends when formulating business plans, compared to only eight per cent of medium and seven per cent of low performers. This suggests that high performers are more likely already to have a network of useful sources to whom they might appeal for advice, when required, relative to less well-performing firms.

High performers were slightly more likely (60 per cent) to take into account the experience of other, similar businesses when making strategic decisions [*cf.* Hay *et al* (1993)], as compared to 55 and 56 per cent of medium and low performers, respectively. Conversely, they were slightly less likely (50 per cent) than both medium and low performers to consider other firms' experience in terms of operational or day-to-day decisions, as compared to 57 and 53 per cent of the medium and low performers, respectively. This again supports the case study evidence, which suggests that high performers are less likely to need help in the daily running of their business, knowing what they want to do and how to do it; whereas they are more likely to acknowledge the fact that what went wrong for someone else could also go wrong for their own firm, unless they actively try to prevent it; and they also show a much greater self-awareness than the lower performers of their rivals, and of the need to 'poach' customers, if necessary.

In terms of who makes decisions in the business, the administered questionnaire data confirm the case study evidence that both strategic and operational decisions are most likely to be made by one person in the high performing firms (60 and 70 per cent, respectively); compared to medium performers (49 and 53 per cent) and low performers (41 and 54 per cent), who are generally more inclined to discuss decisions, whether they have long-term strategic or short-term day-to-day

implications.<sup>9</sup> This suggests that the low performers are perhaps spending too much time discussing plans, while the highest performers just ‘get on with it’, doing the job without too much time being wasted on talking about things, reflecting the fact that “only the ... owner has the business perspective, the ability to orchestrate a company’s activities, the responsibility for setting objectives and the authority to review and change them” [Shuman and Seeger (1986, p.12)]. The hours spent by the lower performers on chatting about the business might be diverting their attention away too much from the actual goal of carrying out the work and getting the business completed. Contrast this with Hofer and Sandbergs’ (1987, p.22) “successful entrepreneurs”, who “focus on opportunities, ... are goal-oriented ... are able to envision where the company is going and thus are able to provide a strong sense of strategic direction”.

Turning now to the question concerning advice sought when formulating strategy, is it sought from outside, or is the business capable of dealing with such decisions in-house? The results were fairly similar across performance groups for more operational decisions, involving advice on accounting, insurance or legal representation; most would employ the relevant experts, paying them for their services. For important strategic matters such as new investment, the high performers were more likely (60 per cent) than the medium (34 per cent) performers to seek outside advice, although 59 per cent of low performers would also seek such advice. However, high performers were by far the most likely (83 per cent) to pay for it, compared to around one-quarter of the other two groups. Again, high performers would seek advice on personnel matters 44 per cent of the

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<sup>9</sup> See Bamberger’s (1983) discussion on the influence of the owner-manager’s values on the strategic behaviour and performance of the firm.



time, compared to 17 and 23 per cent of medium and low performers; about one-quarter of each group would pay for such advice.

Although low performers were the most likely (45 per cent) to seek advice on marketing, compared to 27 and 30 per cent of medium and high performers, respectively, reflecting their awareness of a need to market their business and a lack of knowledge in how to do so, they were only half as willing (34 per cent) as the high performers (75 per cent) to pay for such advice. Similarly, for advice on new products, between 20 and 27 per cent of all firms would ask others for advice but, while 100 per cent of high performers showed a willingness to pay for this, only 43 per cent of medium and 58 per cent of low performers would pay, preferring instead to rely on friends or local enterprise agencies and networks who might offer free advice [*cf.* Johnson and Devins (1994); Storey (1994); Woods, Blackburn & Curran (1995)].

The administered questionnaire asked for the level of importance of information technology to the firm, graded on the scale zero to two, representing least to most important. The results are consistent with the case study evidence, with high performers ranking IT on average at 1.8, medium at 1.5 and low at 1.4; in other words, decreasing in importance, the lower the performance group. By far the most heavily used information technology was the phone, with just under 100 per cent using it to assist in the running of their business, followed by answering machines, which were used by between 74 and 79 per cent of firms. High performers made most use of mobile phones (70 per cent), fax machines (90 per cent) and personal computers (90 per cent), compared to medium performers (51, 72 and 70 per cent, respectively), and low performers (33, 70 and 70 per cent, respectively). An electronic database was said to be used by around 40 per cent of

all firms, although it was sometimes unclear as to whether this was the firm's own customer database, or an external source of information, for example, an on-line database on the industry or competitors.

High performers were also the highest users of radio communications (10 per cent), satellite links (10 per cent) and telephone conferencing facilities (20 per cent), with others making relatively little use of these. Electronic mail, or 'e-mail', was used by only 8 per cent of low performers, but was slightly more important to medium (19 per cent) and high (10 per cent) performers; but video conferencing was rarely used, if at all, and the microfiche was seen to be old technology, although 10 per cent of high performers still used it to some degree, compared to 5 per cent of all others.

The majority of all firms who had implemented information technology used it for administrative purposes, to keep track of their buyers, suppliers and invoices. Forty per cent of each of the high and medium performers used it to develop a business plan, compared to 54 per cent of low performers; perhaps a higher number because the lower performers were more likely to use a computerised custom-made package, whereas the more knowledgeable higher performers might have better capabilities to design their own plan. It is interesting to note that the lower performers admitted to using IT relatively infrequently for networking (46 per cent), which lends support to the argument of Curran (1996) that most small firms have neither the time nor the inclination to network. Compare this to the 70 per cent of both medium and high performers who claim that they *do* network, supporting Steene's (1991) and McNicoll's (1994) theories that greater networking capabilities lead to higher performance. Similarly, one fifth of high

performers also used technology to track or follow the activities of their competitors.

Perhaps quite a telling point is that 80 per cent of high performers used IT to carry out their own accounting procedures, compared to 56 and 57 per cent of medium and low performers. This shows that they were the most likely group to have at their fingertips an up-to-date picture of how their firm was performing; and an understanding of the financial implications of various actions. The lower performing firms were more likely to employ an independent outsider to produce the figures on behalf of their business.

It is perhaps surprising to note that the high performers are the least likely (10 per cent) to use IT in the actual production process of manufacturing their product or providing their service, compared to a high 49 per cent of medium and 26 per cent of low performers. It may be that the current economic climate in Scotland favours the service sector over manufacturers, so service providers are more successful and IT is not so valid in the provision of their product. There are many service sector firms who might use IT to assist in providing their service, such as distributors, business services and education providers; but these do not appear amongst the high performers. The evidence suggest that those businesses in high-technology industries are not necessarily more likely to succeed than those in low-technology industries which, to some extent, refutes the assumption of Cooper *et al* (1991) that firms producing high-technology products will automatically perform better. Instead, it seems that a firm is likely to perform better if it can successfully install and implement technology to improve the speed and efficiency of its information retrieval, analysis and communications.

Let us now investigate a new proposition:

P<sub>4</sub>: mere *belief* in the importance of information technology is not directly related to small firm performance.

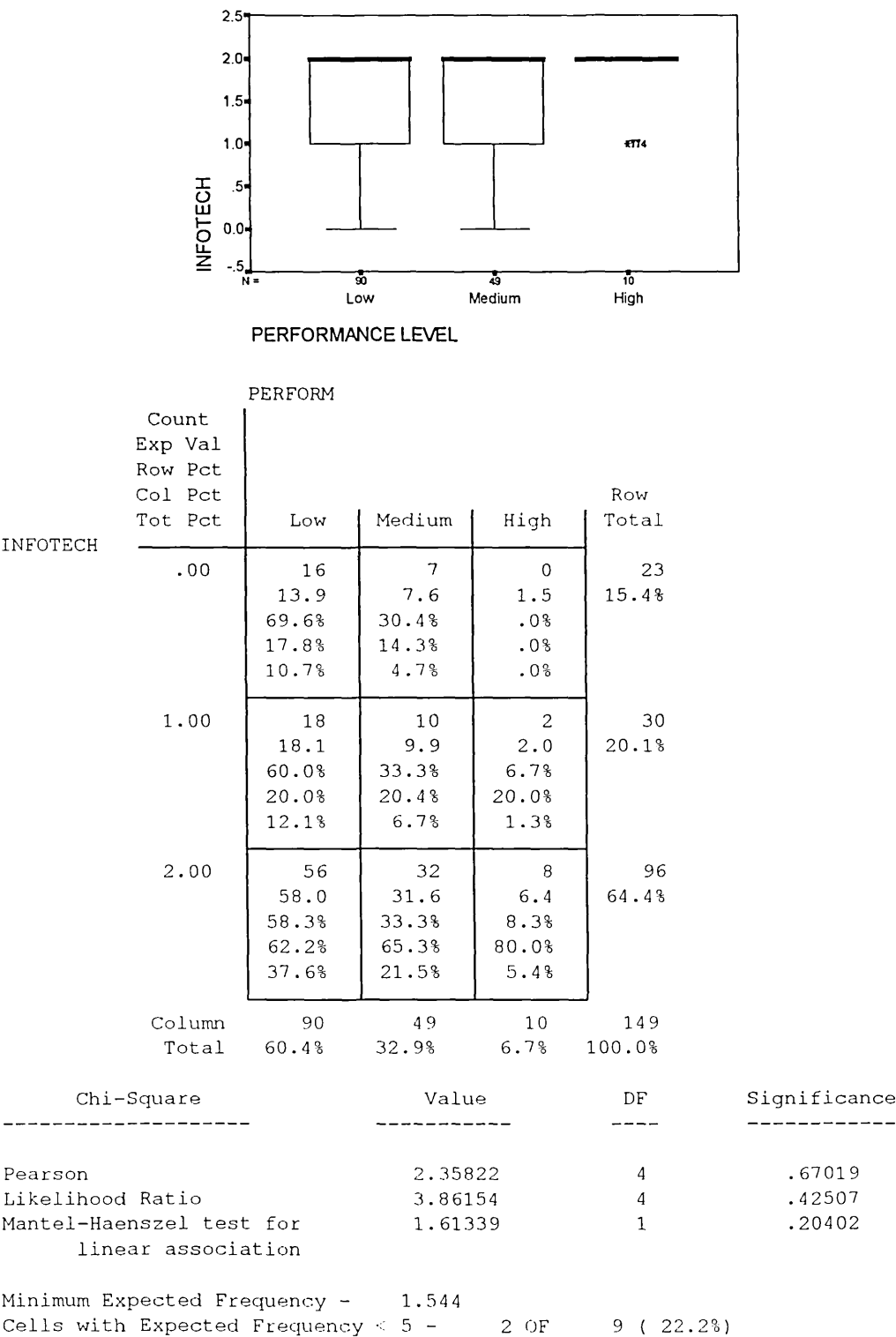
The variable *Infotech* is a measure of the respondent's belief of the importance of information technology to his firm. It is coded as '0' for scarcely, '1' for moderately and '2' for very important. The results for this variable have been cross-tabulated against performance group, and are presented in both boxplot and tabular format in Figure 5.5. From the boxplots, it can clearly be seen that the low and medium performers have very similar beliefs about the importance of information technology to their business. The responses range from scarcely, through moderately to very important, with the majority believing it to be of at least some use. The high performers, however, all appear to think IT is important, the majority saying that it is very important.

The cross-tabulated results break down this information into more detail. 17.8 per cent of the low performers believe IT is scarcely important to their business, compared to 14.3 per cent of medium, but none of the high performers. One-fifth of each performance group believe it to be moderately important. And 62.2 per cent of low performers, 65.6 per cent of medium performers and 80 per cent of high performers believe IT to be very important to their business.

These results are interesting in that the descriptive statistics suggest a high perceived importance of IT to each performance group, but especially so amongst the better performers. However, given the sample size, any formal statistical inferences that may be made on the basis of this evidence are equivocal. For the Pearson and the Likelihood Ratio tests, relatively high probabilities are indicated to the effect that the results obtained may be due to chance (67% and 45%).

# **BOXPLOT AND CROSS-TABULATION OF BELIEF OF IMPORTANCE OF INFORMATION TECHNOLOGY BY PERFORMANCE GROUP**

**Figure 5.5**



However, the Mantel-Haenszel test for linear association indicates there is only a 20% probability that the pattern is due to chance. We conclude that a respondent's *belief* in the importance of IT to the firm does not necessarily translate into performance. A further proposition may now be formulated:

P<sub>5</sub>: *actual* use of information technology is directly related to small firm performance.

This will now be investigated by creating and examining a new variable for the actual use of IT, called *Ituse*. This variable measures the actual use of IT by the firm, by taking the sum of the responses for 12 possible uses<sup>10</sup> of IT, where a positive response to use takes the value '1', and a negative response, the value '0'. The maximum value of *Ituse* is therefore 12, and the minimum, zero, where a higher value indicates more intensive use of technology.

This 'count' variable is used as an indexation factor<sup>11</sup> to generate new boxplots, as shown in Figure 5.6. It suggests that actual use of IT is greater, the higher performing are the firms. The median value for both low and medium performers is 4, compared to 5 for the high performers. What is more, the spread or dispersion of values is greater for the low and medium performers, compared to the high performers. The boxplot displays a considerably lower dispersal of the *Ituse* variable for high, compared to low performers. High performers appear to agree on a level of IT that maximises its use and potential for their firms, whereas the lower performers have yet to agree on an optimum strategy for IT implementation.

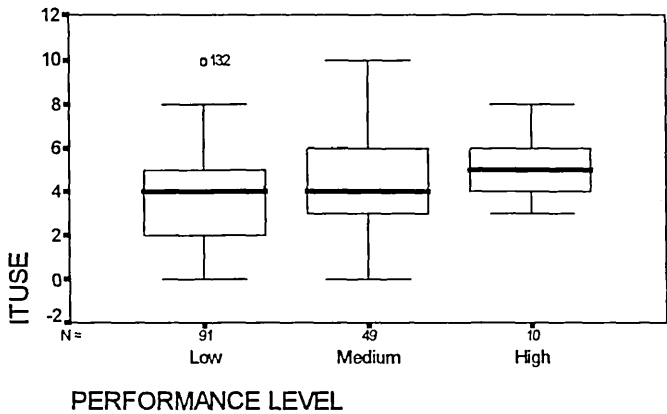
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<sup>10</sup> Telephone, fax, answering machine, electronic mail, telephone conferencing, video conferencing, mobile phone, satellite link, radio communication, microfiche, personal computers, electronic databases.

<sup>11</sup> The author is grateful to Professor Christopher Jensen-Butler of the University of St Andrews, for suggesting a variable such as this might be worth exploring.

# BOXPLOT AND CROSS-TABULATION OF ACTUAL USE OF INFORMATION TECHNOLOGY BY PERFORMANCE GROUP

Figure 5.6



		PERFORM			
ITUSAGE	Count				
	Exp Val				
	Row Pct				
	Col Pct				
	Tot Pct				
		Low	Medium	High	Row Total
	Low	30	10	0	40
		24.3	13.1	2.7	26.7%
		75.0%	25.0%	.0%	
		33.0%	20.4%	.0%	
		20.0%	6.7%	.0%	
	Medium	58	31	8	97
		58.8	31.7	6.5	64.7%
		59.8%	32.0%	8.2%	
		63.7%	63.3%	80.0%	
		38.7%	20.7%	5.3%	
	High	3	8	2	13
		7.9	4.2	.9	8.7%
		23.1%	61.5%	15.4%	
		3.3%	16.3%	20.0%	
		2.0%	5.3%	1.3%	
Column	91	49	10	150	
Total	60.7%	32.7%	6.7%	100.0%	
Chi-Square		Value		DF	Significance
-----		-----		----	-----
Pearson		12.95880		4	.01148
Likelihood Ratio		15.41963		4	.00391
Mantel-Haenszel test for linear association		11.23982		1	.00080
Minimum Expected Frequency - .867					
Cells with Expected Frequency < 5 - 3 OF 9 ( 33.3%)					

For expository purposes, IT has been divided into the three groups of low, medium and high intensity of use, with 'low' containing values of 0 to 2, inclusive, 'medium', containing values of 3 to 6, inclusive, and 'high', containing values of 7 to 10, inclusive, with 10 being the maximum observed. This creates a new variable, *Itusage*, which may assume just three values. Figure 5.6 shows the cross-tabulation of what is now called *Itusage* (rather than *Ituse*) with performance. The low users are also most likely to be low performers, with 33 per cent of them falling into this category, compared to 20.4 per cent of medium and no high performers. In the medium category of IT use fall 63.7 per cent of low, 63.3 per cent of medium and 80% of high performers. And finally, only 3.3 per cent of low performers fall into the category representing the highest use of IT, compared to 16.3 per cent of medium and 20 per cent of high performers. In this case, the Pearson test's  $\chi^2$  value has a probability of just 0.01148, and the Likelihood Ratio test's  $\chi^2$  value has a probability value of 0.00391. The Mantel-Haenszel test for linear association gives a highly significant (0.0008) test statistic. In other words, the probability of obtaining these results simply by chance is extremely small. Taking full account of the forms of evidence presented, we conclude that the greater the level IT use in the firm, the better it is likely to perform. Thus Proposition 5 is supported, leading to the conclusion that operationally using IT is what counts for performance [*cf.* Dodgson and Rothwell (1989)], as distinct from merely a belief that IT is useful [*cf.* Proposition 4].

To conclude, we saw that the majority of firms *believe* that IT is very important to their business, but that this belief is not significantly related to performance. However, we also found that *actual* use of IT *is* related to performance; and the more it is used, the higher is performance, to an extent which is highly statistically



significant. The relative inability of firms to relate their belief in the importance of IT to its actual importance is consistent with earlier findings [*cf.* Reid and Smith (1996)] that lower performers also have a lower awareness of their capabilities and opportunities than do higher performers. The latter are more focused, with more similar strategies within their group, than firms at the other two levels of performance, who vary widely in their capacities for self-analysis and evaluation.

#### *(iv) Policies*

This final section under the heading of ‘strategy formulation’ considers the policies adopted by the firm; what are the ground rules it is following to make sure the job is done properly? It looks at the maintaining and enhancing of product quality; for example, has the firm installed a total quality management system, or TQM? [*cf.* Hanks (1993a)]. What kind of assurances does the firm give to its customers that the final product will be ‘fit for their intended purpose’, and of a suitable quality? And how are employees motivated to co-operate with management in the implementation of new policies?

#### *High Performers*

The three high performers all either used or supplied products that had been manufactured elsewhere, so to some extent they were dependent upon the quality produced by their suppliers: “the majority of our suppliers are ISO9000<sup>12</sup>” (*Case K*). Quality therefore very often came down to the service provided by the firm. *Case C* said that, “if there was a recurring fitting problem, I’d address this in a

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<sup>12</sup> An International Standard of quality, recently superseding the British BS5750.

training way”, and often relied on “the customer telling us” about any trouble they had; *Case K* would inspect all materials as they received them, saying “it’s all checked and signed”; and *Case L* said that quality was “monitored on a daily basis by the personnel in here”, who would go out regularly to make on-site inspections.

The products were often supported by a manufacturer’s guarantee, but the high performers all tried to assure potential customers in other ways. *Case C* would try to guide them to the correct selection of product for their need”, and “match the right price with something that will give them long-term use”; *Case K* played on the fact that customers were “dealing with a company that has a reputable track record for supplying a good quality product”, and that “if we supply a sub-standard product then we will replace it”; and *Case L* offered “a standard guarantee”, allowing customers to “hold a retention of up to 2.5 per cent of the contract value”.

Two of the high performers thought that their staff were very much self-motivated, but they all nonetheless offered incentives to keep and improve their motivation. First, there were the non-pecuniary benefits offered by management: “I encourage them” (*Case C*); “they are involved in decision-making and we value their opinions” (*Case K*); and “we have a good working relationship; we make decisions together” (*Case L*). Then, there were the financial rewards and various other perks: “one is on commission, and one has a net profit-related bonus; the fitters are paid on a piece-work basis so there are financial incentives for them to be profitable” (*Case C*); “at the end of the year they get a bonus, and they get a good Christmas party” (*Case K*); and “money is the first motivator; there’s a bonus for the site workers of one-and-a-half or double pay on Saturday and Sunday” (*Case L*).

Quality and reputation were important to the high performers, who followed policies that would assist them in their search for excellence. Materials were checked on delivery, and the installation or provision of the service was monitored regularly by senior personnel. Customers were offered guarantees and replacements if quality was not quite up to scratch. The personnel of each high performing group were obviously highly valued. They were encouraged to participate in decision-making and offered financial incentives to motivate them and encourage their loyalty to the firm.

### *Medium Performers*

Of the medium performers, two thought it very important to be aware of the market in helping to maintain and enhance quality: *Case B* tried to “stay one step ahead of the game”, and *Case G* used trade journals to find out “what’s happening and what’s going on”. Others relied on regular monitoring of the products and services: “we have various levels of quality assurance as it goes into production, then we have formal quality assessment tests” (*Case H*); *Case I* carried out “regular checking” and had foremen on site who were responsible for quality on a daily basis; *Case J* would ask suppliers “about the quality of the fabric and how they’re cleaned”, checking personally all items when returned from hire; and *Case N* would “randomly check items, where I think something could go wrong”. Only *Case G* mentioned a “procedure manual”, in which were held the “basic functions”.

The medium performers used various methods to assure their customers about quality and ‘fitness for purpose’. *Case B* would tell the customers that their product (i.e. the hotel) always had an approved rating, and would “tell them what has to be achieved for this rating”; *Case J* would be “completely honest” about her

hired goods, and their previous use; and *Case N* offered a “no quibble guarantee”, which meant that products would be replaced if faulty. Some involved the customers in the actual manufacturing process: *Case H* said “they assure themselves; the client is involved throughout the development of a new product”; and *Case J* would “follow the specifications of their designer and architect”. *Case G* relied on “payment” to assure the customer that his product would be suitable: “if doesn’t do what it should, then they don’t pay me”.

Some of the medium performers motivated their employees through a form of financial reward, or intended to do so: *Case B* offered “bonuses based on targets”; *Case G*, a “company car, non-contributory pension, and salary linked to profitability”; *Case H* was “going into share options and profit-related bonuses”, and *Case I* had pension schemes in place”, and was considering profit-related pay. Other forms of motivation included *Case B*: “they are very much involved in decision-making; we listen to their ideas”; *Case H*: “we try and provide a quality work environment and social events; we empower them, so they are in charge of their own work”; *Case I*: “we are thinking of ‘Investors in People’, to let the guys know what we’re trying to achieve and how we intend to achieve it”; *Case J*: “they are very closely involved in the business and decision-making”; and *Case N*: “I try to share the vision of the business with them and keep them informed of the happenings of the business”.

The medium performers were quite likely to have been developing a structured type of quality assessment, with regular checking or monitoring of the product. Customers were assured of quality partly through some form of guarantee, and partly through the reputation of the company for supplying a quality product or service. Employees were most likely to be motivated through their involvement in

decision-making; but medium performers were also making efforts to install or increase financial rewards; and most seemed to be currently in a transitional phase, with ideas for improvement soon to be implemented.

### *Low Performers*

Most of the low performers were unlikely to have complicated procedures for assessing quality: “we take our time and concentrate on what we’re doing” (*Case A*); “it’s more with the manufacturers; I take their word for it” (*Case E*); “we rely on our own judgements as to what’s acceptable” (*Case F*); and “I’ve been in it for a few years and you get a standard you set” (*Case O*). Others relied on occasional ‘spot-checking’; *Case D* would either “always be there, or turn up unannounced”; *Case M* would “inspect every job when it’s finished”, as well as having foremen on-site; and *Case P* would “keep a regular check on what they’re doing”.

Low performers were likely, in most cases, to give a guarantee only if the customer requested it, relying instead on their reputation being enough to assure customers. *Case A* would “have a five minute discussion” with the customer, and “if they ask for it, we give guarantees”; *Case D* said that reassurance “has to be verbal”; *Case E*, that “they know I exchange things”; *Case F*, that “we will go back and sort out any problems”; *Case P*, that “*If they’re anxious*, I phone up suppliers and ask for a ten or fifteen year guarantee”; and *Case Q*, “If there’s anything wrong we replace it”. *Case O* used payment to reassure customers, though not through his own volition: “if it’s not up to scratch or standard, they don’t pay you”; and *Case M* offered “an insurance-backed thirty-year guarantee”.

Not all of the low performers had employees, so motivation for them was not an issue. Of the others, only two offered financial incentives: *Case M* gave a “profit-

sharing percentage and bonuses”; and *Case P*, “a productivity bonus related to the individual job”. The rest relied on encouragement and a convivial working atmosphere. *Case A* said “it’s easy come, easy go”; *Case D* used “pure encouragement”; *Case E*’s employee “works flexible hours”; *Case F* treated their employee “as if he *was* a partner”; *Case M* would “consult them for a decision”; and *Case P*, on encountering a problem with his employees, would give them (metaphorically) “a size eight boot in the wrong place”.

Low performers were informal in their quality procedures, preferring not to mention guarantees unless pressed by the customer. There would be occasional monitoring or on-site checking, but this appeared to be less regular than the procedures followed by the higher performers. Perhaps because they *were* lower performers, and therefore had little spare cash to distribute, this groups of firms rarely offered employees financial incentives. Instead, they tried to create an environment that was friendly, where everyone had a say in decisions and the future of the company.

### *Conclusions*

Classifying the case studies by performance groups, in terms of the policies they had adopted, suggests the following characteristics relate to each group. First of all, the high performers relied mainly on the quality of their suppliers, in terms of the actual products, but service quality was maintained by regular checking or monitoring, and addressed by training if it were not up to standard. Perhaps the greatest difference between the high performers and other groups lies in the pecuniary benefits paid to ensure staff loyalty and motivation; these being much greater amongst the higher compared to the lower performers.

Medium performers very often had a regular monitoring or checking system in place. They reassured their customers by their reputation and occasional guarantees; and motivated employees through their involvement and financial bonuses, though to a slightly lesser extent than the high performers. Low performers rarely gave guarantees to customers, and quality was not typically formally checked on a regular basis. They were the group least likely to give monetary rewards to employees, relying instead on their self-motivation through the encouragement they received.

### *Supporting Evidence*

Once more making appeal to the quantitative data available from the administered questionnaire, the evidence show that high performers were the most likely (20 per cent) to have implemented a total quality management system, with half doing so because they thought it increased efficiency, and half because of the cost benefits it conferred [*cf.* Hanks (1993a); Madu and Kuei (1993)]. Twelve per cent of the medium and 16 per cent of the low performers had implemented such a system, be it a formally approved system, installed with the help of consultants, or one developed through their own initiative. Medium performers were most likely to think it helped to improve their business image (50 per cent); whereas low performers were using it mainly to increase efficiency (36 per cent).

One-fifth of high performers had achieved formal accreditation for some aspect of their personnel handling, and all were convinced that this had helped to improve motivation. This supports the case study evidence that suggests higher performers value their staff more than other groups. They are also the most likely to provide staff with financial motivations. Only two per cent of medium, and seven per cent

of low performers had achieved similar approvals for personnel. All of the medium performers had sought such approval to improve motivation, whilst the low performers thought it helped motivation (33 per cent), improved the business image (17 per cent), and led to increased efficiency (17 per cent).

#### **5.4 Summary**

Chapter 5 has discussed in detail the data generated by the case studies, analysing the firms by the low, medium and high performance group into which they fall. The discussion is supported by quantitative data from the administered questionnaire, which provide summary statistics for each performance rank. In addition, five propositions were developed, prompted by the analysis of the data. These propositions were tested using statistical methods, and illustrated by boxplots, cross-tabulations and graphs, with supporting chi-square statistics, where relevant.

In terms of environmental scanning, the higher performers seemed to have a better awareness of the market, clearer reasons for start-up and more of an idea of their environment than did the lowest performers, with medium performers falling somewhere between the two. The majority of all firms were pleased with both customer and supplier relationships, perceiving few, if any, problems.

The key results from this section are found in the analysis of propositions one to three. First, there is evidence that young, small firms will over-exaggerate their strengths, and under-estimate weaknesses or potential threats, either through naïveté [*cf.* Jovanovic (1982)] or through a deliberate attempt to withhold information, perhaps in order to disguise any problems from outside backers [*cf.* Reid, Terry & Smith (1997)]. Second, the proposition that those owner-managers



who are more realistic that about strengths, weaknesses, opportunities and threats will also perform better is supported to some degree by the data. And examination of the third proposition, that the more information a firm has on its rivals, the better will be performance, shows some linear association between information gathering and performance [*cf.* Madu and Kuei (1993)].

In terms of strategy formulation, high performers were most likely to plan further ahead, and to have clearly defined goals. Low performers often had a business plan which was not used in the running of the business, but instead had been developed to attract start-up support [*cf.* Baker *et al* (1993)]. High performers sought long-term economic objectives, such as a high rate of return, medium performers often wanted long-term profit, and low performers often hoped for no more than mere survival or, eventually, increased sales.

High performers were clearly focused, medium performers less so, and low performers seemed even less certain of what they wanted to achieve from their business. The high and medium performers could be said to have well-defined strategies, whilst the evidence appears to suggest that low performers do not generate strategies in a formal, text-book sense. Of those firms who do have strategies, the high performers seemed more able to make quick decisions on which options to take, perhaps because the owner-managers were more natural entrepreneurs. Medium performers, on the other hand, would spend much time analysing options, generating budgets and projections, before deciding which route to take, possibly because they were less naturally entrepreneurial by nature, but were perhaps higher educated or open to the idea of technical project appraisal.

The educational level of each performance group might be worth examining to investigate this proposition.<sup>13</sup>

The use of information technology within small firms was thought to be worth exploring in further detail, leading to the development of two more propositions. The first examined the belief of the importance of IT to the firms under examination. Given that most respondents appeared to think it was important, the proposition was that the belief of this importance was not reflected in performance. Examination of the evidence shows that we can, with some confidence, take this to be the case. The final proposition in this chapter suggests that the *actual* use of information technology *does* translate into performance. A new indexation variable is created to test this proposition and, when cross-tabulated with performance rank, it is found to be highly statistically significant. In other words, the higher the use of information technology in a new small firm, the better will be its performance.

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<sup>13</sup> See, for example, Mintzberg and Quinn (1991, p.817), who believe that “formal management education programs typically emphasize the development of problem-solving and decision-making skills, for instance, but give little attention to the development of skills required to find the problems that need to be solved, to plan for the attainment of desired results, or to carry out operating plans once they are made”.

## Chapter 6

### Case Study Evidence: implementation of strategies and the evaluation of performance

#### 6.1 Introduction

Chapter 6 concludes the discussion of case study evidence, again making appeal to the case studies in Appendix IV, and supporting the discussion with further detail from the administered questionnaire. It begins with an examination of the process of strategy implementation, looking at the firms' programmes, budgets and procedures. The chapter concludes with a discussion of the methods used to evaluate and control strategies.

In a similar way to the methods used in Chapter 5, a further two propositions are developed, and illustrated by boxplots, cross-tabulations and chi-square statistics. The first proposition suggests that access to more sources of funding will in turn lead to enhanced performance. It is shown that, in fact, this supposition cannot be supported by the available evidence. The second proposition is that a willingness by the owner-manager to dilute their equity shareholding in the firm will correspond to higher performance [*cf.* Storey (1994)]. Again, we cannot accept this proposition and, indeed, there is evidence to suggest that the willingness to accept a higher dilution of equity will *not* improve performance.

## 6.2 Strategy Implementation

### *(i) Programmes*

The first section under the heading of 'Strategy Implementation' investigates the programmes followed by the firm; how does it organise its operation to implement its strategic plans as quickly as possible with the highest quality possible? It examines what is being done by the firm to help it achieve its goals in terms of, for example, the introduction of new products, investment or additional staff. It then looks at feedback from customers, and how this is used to improve the firm's product or service. Following this, the study looks at problems encountered by the business in implementing new strategies, factors determining the speed of their implementation and potential constraints on the future growth of the firm.

### *High Performers*

The three high performers were all taking positive steps to help achieve their goals of growth and high profitability, employing new staff, moving into new premises and seeking out new lines of business as "the lack of resources to carry out some aspect of [a] plan must be identified before implementation begins" [Shuman and Seeger (1986, p.13)]. *Case C* was "creating and maintaining a profitable core that will drive forward growth, taking on new staff, and looking at new premises", with a view to opening a new retail outlet. *Case K* had "moved to new premises and paid people off to bring the overhead down" and was "taking on new products", whilst their main asset, the newly-purchased premises, was appreciating in value; and *Case L* was "always trying to increase the market" and had "built up a bit of finance that can be invested" [*cf.* Bull (1993)].

## RECEIPT AND USE OF CUSTOMER FEEDBACK

Table 6.1

	<i>Receive Feedback?</i>	<i>Use of Feedback</i>
<b>High Performers</b>		
CASE C	✓	quality control
CASE K	✓	naïve and ignorant to ignore it
CASE L	✓	use as reference to other customers
<b>Medium Performers</b>		
CASE B	✓	clients are unpaid inspectors
CASE G	✓	for motivation and improvement
CASE H	✓	to constantly adapt
CASE I	✓	comments go to the shop floor
CASE J	✓	absorb and alter
CASE N	✓	put into effect
<b>Low Performers</b>		
CASE A	✓	to improve
CASE D	✓	questionnaires seek customer reaction
CASE E	✓	to improve quality
CASE F	✓	note any problems
CASE M	✓	to correct
CASE O	✓	take it on board
CASE P	✓	recommendation to clients
CASE Q	✓	letters of commendation on door

*Note:* ✓ - yes

All of the high performers received feedback [cf. Table 6.1] from their customers which, if relevant, they would use to help improve the quality of their product or service [cf. Thurston (1983)]. *Case C* would have “ad hoc” meetings with his key fitter, during which any problems were discussed; he used customer feedback for “quality control”, to help keep him informed if things went wrong. *Case K* said that actions taken because of customer feedback were “very spontaneous”, and that it was “naïve and ignorant to ignore complaints”; and *Case L* used feedback “as a reference, if nothing else”.

One of the high performers, *Case C*, said that he could not recall encountering any problems in implementing new strategies, mainly because his business was “quite firmly focused” [cf. Table 6.2]. The two others had both had difficulties at some point. *Case K*’s solution was “to bite the bullet” because it was to be expected that “things don’t go right”. Their reaction to problems was that “if you believe in it and stay the course, then you’ve got to follow it through”. *Case L* had experienced difficulties in the past with trying to attract new customers, because “the probable client is already happy with who he’s got working for him, and is reluctant to move”; he therefore had to use advertising and price-cutting to try and get their custom. See Mintzberg and Quinn (1991, p.818), who believe that, “while the analytical skills needed for problem solving are important, more crucial to managerial success are the perceptual skills needed to identify problems long before any evidence of them can be found by even the most advanced management information system”.

This group of firms had mixed reactions as to the importance of speed in implementing new strategies. *Case C* said it would depend partly upon the

# INDICATION OF PROBLEMS ENCOUNTERED IN THE FIRM

Table 6.2

	<i>Problem Encountered?</i>	<i>Nature of Problem</i>	<i>Reaction to Problem</i>
<b>High Performers</b>			
CASE C	✗		
CASE K	✓		to be expected; stay the course; follow through
CASE L	✓	attracting new customers	advertising and price-cutting
<b>Medium Performers</b>			
CASE B	✓	changing systems; time constraints	re-training
CASE G	✓	people	break down barriers of society
CASE H	✗		
CASE I	✗		
CASE J	✓	organisation	changing procedures
CASE N	✓	staff tidiness	built more shelf space
<b>Low Performers</b>			
CASE A	✗		
CASE D	✓	logistical	rework timetable
CASE E	✓	money and space	
CASE F	✓	skills lacking	
CASE M	✗		
CASE O	✗		
CASE P	✓	staff failure to abide by Health & Safety regulation	
CASE Q	✓	product lines not selling	

Note: ✓ - yes  
✗ - no

financial situation of the firm at the time, although “people are key at the end of the day”, so not having the right staff would prevent things from moving too quickly. *Case K* admitted that they were very slow at following new ideas because “it’s our lives we’re playing with, so we like to be belts and braces sure”; but *Case L* thought that “you’ve got to be fairly swift if you make a decision”.

All three firms were quite sure about what was the biggest constraint on the future growth of their business: *Case C* said that it was, quite simply, “finance”; *Case K*, “the market, and lack of local government spending at the moment”; and *Case L*, “a lack of confidence in the building trade as it is at the moment”. The latter two were both, to some extent, dependent upon the local building trade and local government contracts, so the recent re-organisation of local government had affected their trade and made them slightly cautious about the future.

The high performers were investing heavily in the future prospects of their firms, buying premises and trying to create a core team of staff who would see the firm through its future stages. Trying to maintain high profitability was a key concern, so *Case K* had taken the difficult step of letting some staff go. These firms were all open to hearing feedback from customers, and using it when necessary to improve their service. Two firms, realistically, admitted that problems did occur, though they fought hard to combat them; and one said that his firm was so well-focused that problems were infrequent. Speed was not always important in implementing new courses of action, which were dependent on the financial situation of the firm, or the current state of the market.



### *Medium Performers*

The medium performers, too, were investing heavily to try and achieve growth, with many taking on new staff to assist in the process. They also mentioned various other actions being taken, for example, to help increase turnover: *Case B* would “target an area” offering “specials” to attract new customers; *Case G* was “reinvesting *all* the money back into the business, bringing in new ideas, and taking on more complicated jobs”; *Case H* had “new contracts, new staff, and equity investment from venture capital”; *Case I* had “regular Board meetings where we review strategy analysis and implement various stages throughout the year”, and were “improving the machinery” whilst “looking for another person for the sales side”; *Case J* had “additional staff” and had “taken on premises double the size”, with an increased product range; and *Case N* was “advertising, prospecting” and working on “a continual all-over upgrading in our appearance”.

All six of the medium performers received some form of feedback from their customers [*cf.* Table 6.1], which was noted and used, when relevant. *Case B* said that “clients are our unpaid inspectors”; *Case G* passed feedback to his staff, using good comments as a motivating factor, and bad to try and improve; *Case H* used on-going feedback to “constantly adapt”; *Case I* listened to “everything they have to say”, again passing comments to the shop floor; *Case J* would “absorb” feedback, altering things if there were a justified complaint; and *Case N* said that “if it sounds reasonable, we put it into effect”.

Two thirds of this group had experienced problems in implementing new strategies [*cf.* Table 6.2], associated with time constraints, organisation and staff problems. *Case B* pointed out that, although “strategies always seem a good idea at the time, it often involves changing systems and re-training, and finding the time

to do it is very difficult” [cf. Shuman and Seeger (1986)]; *Case J* had also found that growth had meant that “the organising of the hire side is much more complicated”. *Case G* found difficulties with people, who “get certain ideas, like ‘it’s not my job; you can’t teach an old dog new tricks’”, and spent time trying to “break down the barriers that society has built up with people”, supporting Johnson and Scholes’ (1984, p.312) finding that “many of the difficulties which can arise during the implementation of strategic change are due to the natural tendency of people to resist change and to fight for the *status quo*”; and *Case N* had experienced problems with staff, and “trying to get them to be tidy”. Of the two that had not yet experienced any difficulties, one, *Case I*, suggested that a “shortfall of quality labour would be the only one”.

Most of the medium performers agreed with *Case B* that “timing in implementing strategies is very important”. *Case G* said that, “for a small company like us, we’ve got to be very fast and very reactive to the customer”; and *Case H* thought that, “if it’s going to make a big impact, then we need to turn it around immediately”. Other factors influencing the speed of implementation were mainly external: “the marketplace dictates to us “ (*Case I*); “I had to move premises very quickly because of the landlord” (*Case J*); and *Case N* had to wait for “the availability of premises” before he could change location.

Different factors were said to be constraining the growth of these small firms, ranging from a lack of suitable staff, a lack of business due to a slump in the industry, and a lack of finance to fund the growth. *Case B* worried that competitors might take their custom away: “when we first started short breaks it was the only one in the markets place [but] now there are others”; *Case G* was looking for “controlled growth as opposed to the explosive-type, which leads to

over-trading and bad management”; *Case H* was restricted by “the speed at which we can recruit” suitable staff; *Case J* by the feeling that “there is a lack of funds generally” and that people simply were not buying; and *Case N*, by a lack of “finance, space and suitable, skilled staff”. Only *Case I* said that “nothing at the moment” was constraining his firm’s growth.

The medium performing firms were implementing new programmes to assist in their aims of growth and profitability, both investing new capital and employing new staff. Feedback from customers was used constructively either to motivate employees, if it were good, or to improve the product or service, if bad. Problems in implementing new strategies were likely to arise through difficulties in finding either suitably qualified staff, or the time necessary to deal with it. The timing of new strategies was generally thought to be important, with some saying implementation should be fast, and others that it depended upon factors external to the firm. Constraints on growth ranged from a lack of spending power amongst consumers, through a lack of suitable staff to implement it, to insufficient capital to fund the growth.

### *Low Performers*

Only two out of the eight low performers had actually invested something more into the business to help achieve their goals of growth: *Case M*, who had “taken on new staff and premises” and reinvested any profit; and *Case P*, who had “bought all the equipment we need to we’re cutting out the hire charges”. The others were trying to grow, either by completing the work they had, or chasing new contracts: “we’re trying to catch up on work that needs doing” (*Case A*); *Case D* was busy “getting feedback” so he knew where to go next; *Case E* was “going out and about

more to be seen and to meet prospective customers”; *Case F* was working on introducing a new product line; *Case O* was also “moving into different markets and trying to find the most lucrative”; and *Case Q* was “extending the product range, working harder, and trying to reduce outgoings”.

All of the low performers received feedback from their customers [*cf.* Table 6.1], and some used positive feedback as a marketing tool: “we usually use it as a recommendation to new clients” (*Case P*); and “we put letters of commendation on the back of the door” (*Case Q*). Others would use negative feedback to improve their service: “if the customer says something we’ll listen intensely and improve on that” (*Case A*); “if it’s of poor quality, I let the reps know so it won’t happen again” (*Case E*); “we note any problems” (*Case F*); “we get the occasional complaint, and we try to correct as we go along” (*Case M*); and “if someone says ‘do something’ you have to take it on board” (*Case O*). Only *Case D* seemed to be actively seeking feedback: “we send out questionnaires to people” to gauge customer reaction and requirements.

Five of this group of firms had experienced problems in implementing new ideas or with existing operations [*cf.* Table 6.2]. These centred around issues such as money, time, space and staff. *Case D* said that problems were “logistical” and concerned “how to cram everything into one day”; *Case E* said “I have not had the money, and space”; *Case F* needed to employ a skilled sales person to help to market the company; *Case P* had trouble “trying to get the staff to abide by Health and Safety regulations”; and *Case Q* had experienced difficulties with new product lines that would not sell. Of those who claimed not to have experienced problems, *Case A* said, confidently, that “if we have an idea, and go and do it, it works”; and *Case O* would get a “brief” from his client, and would “have to stick to it”.

Some of the low performers recognised that speed was an issue in implementing new strategies. *Case A* would “jump on an opportunity [because] speed is very important”; *Case E* agreed that “speed sometimes comes into it”; and *Case O* said that “when you’re doing something you have to get in there pretty quickly before anyone else catches on; you have to react quite quickly”. However, others were held back from making instantaneous decisions: “cost is a very, very important issue when it comes to any action”, said *Case D*; “it depends upon the suppliers, and they’re not always reliable” (*Case E*); “the main problem is that we’re too busy to do it” (*Case F*); speed depends upon “the circumstances at the time” (*Case M*); and “money is holding us back from doing different things” (*Case Q*).

Most of the firms thought that the main thing holding them back from growing was a lack of funds: *Case A* thought that “if we had finance we could rapidly expand” and that “grants would help, but you never hear about them”; *Case D* that, “if we had unlimited amounts [of money] we could move into all sorts of areas”; *Case E* found cash flow a problem, saying: “if you don’t have the money, you can’t get it in”; *Case M* said that “if interest rates go up, we’ll be affected”; and *Case P* said, “I don’t have unlimited cash”. Others needed more staff to help them grow, such as *Case F*, “the problem is that we haven’t got enough labour”; and *Case P*: “you have got to set up a proper system and have the proper people in place”; and *Case O* was worried about “ruthless competitors”, who might steal his business.

The low performers seemed primarily to be hoping for growth, based on what they had already in the firm, in terms of staff, money and premises, rather than investing further capital or assets. They were looking for new business, stocking new products or seeking alternative markets, but were making very little effort to

increase the actual worth of the firm in terms of labour or assets. The firms were mostly likely to be grateful for positive feedback, using it for marketing; to use negative feedback to improve their product or service; but were unlikely to actually ask for feedback. They had experienced some problems in implementing new strategies, with time and money being the key factors. Some thought that speed was important, but most were held back by constraints, mainly on finance.

### *Conclusions*

To summarise the performance groups in terms of their programmes for strategy implementation, let us start, first of all, with the high performers. These businesses were adding to the value of their firms by investing in premises or new staff, and additional products [*cf.* Johnson and Scholes (1984)]. They were willing to take on debt to help in this investment, or to make difficult decisions, such as dismissing employees, to cut costs and thereby improve profitability. They used feedback from customers in a positive manner, holding meetings with staff to discuss problems, in an effort to maintain quality control.

Those high performers who did experience problems in implementing new strategies worked hard to overcome them, whilst one had such a focused strategy that any difficulties were negligible. The speed at which new courses of action were followed was not as important as might have been expected amongst high performers, perhaps because these firms knew well enough what they wanted to do, and had enough time to evaluate a decision before implementing it; although once a decision was made it was important to follow it through. Finance was not the greatest constraint on growth for the high performers [*cf.* Reid (1996b)], who

were more likely to worry about business falling off through a downturn in trade in the industry generally.

The medium performers were investing in the future of their firms, realising that one must 'speculate to accumulate'. Several mentioned taking on new staff, and others were looking for larger and more complicated contracts. They listened to feedback from customers and made changes to their operations if it was thought these would enhance the product or service. More than half of the medium performers had experienced problems, usually concerning organisation or staff management. Most seemed to think it important to be quick and reactive to changes in the marketplace, although some had been forced into making fast decisions because of external influences. Growth of medium performers was being constrained partly through their own reluctance and uncertainty about future business, and partly through a lack of finance, suitable staff or available time.

The low performers were the least likely to have invested any more in terms of taking on new staff or further assets, possibly because they were the most likely not to have available profits to reinvest. Instead, they were trying to heighten customer awareness by 'cold-calling' on new clients and offering a wider product range. They paid attention to customer feedback, and often used letters of commendation as an advertising tool. Again, most of the low performers had experienced problems in the running of their business, largely on the organisational or staffing side. Some of the low performers thought that speed was important when it came to implementing new courses of action, but finance was a major constraint on any new idea.

### *Supporting Evidence*

The administered questionnaire offers additional insight into the gathering and use of customer feedback by the small firms in the study. One hundred per cent of both high and medium performers said that they did receive feedback, compared to only slightly fewer (97 per cent) of the low performers. Sixty per cent of high performers would ask for feedback, and 70 per cent were also given it freely, compared to 63 and 82 per cent, respectively, of medium performers; and 76 and 76 per cent, respectively, of low performers.

Of those who did receive feedback, 80 per cent of high performers, slightly more medium performers (82 per cent), and again more low performers (86 per cent) would take either a written or mental note of the comments. Between one half and two thirds of all firms would discuss comments with other customers. All of the high performers (100 per cent) would make changes based on customers' suggestions, compared to 80 per cent of medium and 87 per cent of low performers; and none of the high performers (0 per cent) would do 'nothing' about feedback, compared to four per cent of medium and one per cent of low performers, showing that nearly all firms realised the importance of adapting to the customer's specific requirements.

### *(ii) Budgets*

This section investigates the methods by which small firms aim to finance their stated aim of growth. It will examine the owner-manager's awareness of budgets; how much is it going to cost, and where can they get the cash? Is cost control important to their operations? What are the principal components of their budgetary procedures; and have outside sources of advice on finance, such as



accountants, bank managers and local development companies, helped in formulating budgets?

### *High Performers*

The high performers all thought that they could sustain growth through reinvested profits, and would rather seek equity investment than debt financing if further funds were required. *Case C* expected growth to occur “organically, through reinvested profits” and would “consider both debt and equity, but not at the moment; and I would favour investment”. *Case K* also expected profits to finance growth, and had received grants and a loan to help. In addition, they would “do deals with our suppliers to extend trade credit, and monitor stock; we’re sensible”. *Case L* was, again, funding growth through profits, although he “would take an overdraft, if needed, reluctantly”. They were thus following Bhidé’s (1994, p.156) recommendation that “entrepreneurs should favour ventures that aren’t capital intensive and have the profit margins to sustain rapid growth with internally generated funds”.

Two of the high performers thought that it was currently more important to control costs than to generate revenue through extra sales [*cf.* Table 6.3]. *Case C* had a target profit margin which they wanted to improve, because “that’s where the most effect on our profitability can be made” [*cf.* Churchill and Lewis (1983)]; and *Case K* thought that controlling costs came first in this business, because they were “a well-established company now, there’s a selection of contractors who use us on a daily basis” and, in any case “the sales are the sales”. *Case L* thought that “you should always be controlling costs” so increasing revenue was currently more

# FIRM'S PREFERENCE FOR COST CONTROL VERSUS INCREASED SALES

Table 6.3

	<i>Prefers to Control Costs</i>	<i>Prefers to Increase Sales</i>	<i>No Preference</i>
<b>High Performers</b>			
CASE C	✓		
CASE K	✓		
CASE L		✓	
<b>Medium Performers</b>			
CASE B		✓	
CASE G		✓	
CASE H		✓	
CASE I	✓		
CASE J		✓	
CASE N	✓		
<b>Low Performers</b>			
CASE A		✓	
CASE D		✓	
CASE E		✓	
CASE F		✓	
CASE M			✓
CASE O	✓		
CASE P	✓		
CASE Q	✓		

*Note:* ✓ - yes  
x - no

important [*cf.* Porter (1985)].

Financially, these business had started with often little more than the weekly enterprise allowance: “I started with nothing” (*Case C*). However, with growth and experience, further investment had been achieved. *Case C* said that it had “come through overdraft and profits”; and *Case L* that “there has been little change: I would rather keep money in the company than take it out, and money is always there to be invested for the future”. *Case K* had started with two business loans from the local enterprise trust, now paid back, they made regular use of a £75,000 overdraft facility, and had taken out a mortgage on their new premises.

On a daily basis, all of the high performers looked very closely at cash flow: it was, to *Case K*, “the most important thing at the moment”; and *Case L* used “a HOB<sup>1</sup>S machine to look at cash flow; it’s essential that it’s done daily”. Two of these firms, however, looked at sales and profit margins on a regular basis: *Case C*, because “you don’t look at the cash flow and know accurately what your accounts are; you work out the profit and loss from the cash flow; it breaks things down into manageable bite-sized pieces”; and *Case K*, who would analyse “margin and sales per product group; the product mix is important in terms of the well-being of the company”. Compare this with Thurston’s (1983, p.180) statement that “no capable manager should find surprising news in the monthly financial report [and] the manager for each area of responsibility should have daily and weekly running figures on how that responsibility is performing against plan”. See also Bhidé (1994, p.157), who claims that “the astute entrepreneur ... understands that returns from additional analysis diminish rapidly and avoids using spreadsheet

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<sup>1</sup> ‘Home and Office Banking Service’. This is a small desk-top terminal, introduced by the Bank of Scotland, which enables users to gain on-line access to their business accounts.

software to churn out detailed but not particularly insightful analyses of a project's break-even point, capital requirements, payback period, or NPV".

The high performers were likely to be able to produce their own accounts without any outside help: "it's all done by the time I go to the bank" (*Case C*); "the two of us do the budget, and the accountant does what we tell him" (*Case K*); and "I *know* what I need; the bank manager doesn't care because we're solvent" (*Case L*). Local government and enterprise agencies were generally thought to have been helpful, though non-participatory and not often likely to influence heavily decisions: "I've had training grants and the enterprise allowance, and they've been helpful" (*Case C*); *Case K* had received "grants for property"; and *Case L* had "a little grant at the beginning, and an 80 per cent grant for computer training; the grant influenced me in *doing* that".

The high performers had few, if any, problems with funding, all having managed to reinvest profits since start-up, and aiming to continue in this way. They were good at controlling costs and careful to keep a close eye on cash flow and resulting profit and loss accounts [*cf.* Welsh and White (1981)]. These firms were also willing to take on debt, if necessary, and had demonstrated the bank's confidence in them by making use of loans and overdrafts. Although enterprise agencies and local government bodies had been useful sources of additional funding, their help in budgeting was not required by the high performers, nor was it offered, in any case.

### *Medium Performers*

Most of the medium performers thought that growth could be financed, to some extent at least, through reinvested profits, and some were looking for additional investment. *Case H* hoped to finance growth "through equity and new business";

*Case I* was evaluating the possibility of a merger with someone who “would bring an existing business plus money into our business”; and *Case N* thought growth had “got to be done on the basis of profits reinvested, unless I can get a low cost business loan from the Enterprise Trust; but I prefer to be debt free”.

Two thirds of the medium performers were hoping to increase sales, rather than trying to control costs [*cf.* Table 6.3], although many realised, as in *Case B*, that “the two go hand in hand”, so they “always do control costs”; *Case G* said that “they are both important, but we’ve taken on another, loss-making, company, so we need to make it a profit-making concern”; *Case H*, that “controlling costs is vital, and we’re constantly doing that”, but he wanted to increase sales “because we’re expanding the business”; and *Case J* though that “only by increasing your sales can you invest more in the business and make it grow”. *Case I*, on the other hand, pointed out that “if you control costs within estimates, then profitability looks after itself; it allows expansion, more people, higher profits, and so on” [*cf.* Porter (1985)].

Most of the medium performers had been able to put more money into their business since start-up, be it either further debt or equity, and several had reinvested profits: “everything we’ve done is from the initial investment, which came from ourselves” (*Case B*); “profits have gone back in and we’ve used bank overdrafts” (*Case G*); “equity investment is the main thing; once we are more established we may take on debt funding” (*Case H*); “there was the money I put in, plus bank loan and business overdraft; the loan was a regional mortgage on our house” (*Case J*); and “we started with our own money, and I put more and more into it; I cashed in all my pensions and investments, and have taken out a mortgage on my home for £30,000” (*Case N*).

Nearly all of the medium performers would look at cash flow on a daily basis, and *Case N*, for example, found bank statements useful for telling “how much you have in the bank, and how much business you’re doing on a regular basis”. Others would also look regularly at detailed financial reports, such as *Case B*, who use “full management accounts, turnover and out-goings”; *Case G* used “management reports based on the profit and loss account”; *Case H* thought “the profit and loss account is the most important thing, and is looked at monthly”; and *Case I* would “look at all the financial data and do a detailed cost analysis on each product”.

The medium performers would quite often seek help in preparing budgets: “we ask our accountants if we’re not aware of something, and use them as consultants”, said *Case B*, who had also received “first class help and advice” from various Enterprise Trusts; *Case G* said that “accountants are involved in planning”; *Case H*, that “with a major business plan, we get our accountants [auditors] to work on it”, and “equity investors have a seat on the Board and will take an active role”; *Case J* thought that “accountants are very helpful for preparing budgets”; and *Case N* said “the bank manager is important and has been very helpful”. In addition, *Case H* had “a fully-qualified CA in-house as our financial controller”; and *Case I* had “an in-house accountant who prepares most of this”.

There was a mixed reaction amongst medium performers as to the assistance offered by local government or enterprise agencies to small firms. *Case B* said “we would not be where we are today without them”; *Case H* had received a “small innovation grant, related to capital spending and the money and jobs you create”; and *Case N* had received a “grant for the initial purchase of these premises, and for attendance at shows”. On the other hand, *Case G* thought that such organisations “have been no help at all, and have given nothing, in terms of money or support”;

and *Case I*, that local government had “not been a great help at all [although] the local Scottish Enterprise office has been invaluable, and kept us abreast of new developments” [*cf.* Fass and Scothorne (1990)].

Medium performers were reinvesting profits and seeking additional input from elsewhere, in both debt and equity form. Although they realised the importance of cutting costs, they were currently more focused on increasing turnover and generating extra sales revenue. Careful monitoring of cash flow was important, and some used full management accounts on a regular basis. These firms often used external sources of advice on budgeting, appealing to accountants, auditors, bank managers and enterprise agencies for assistance, although the latter were thought by some to have been of no help at all.

### *Low Performers*

The low performers experienced some difficulties in finding the money to fund growth; some hoped to get bank loans, and others hoped to make profits that could be reinvested. *Case A* was funding growth “through our own savings, off our own back, which is very, very difficult”; *Case D* would do it “hopefully internally, through profits”; *Case E*, through “increased sales [because] I have the stock there”; *Case M*, through “reinvested profits, nothing else”; *Case O* would “hope to get an advance on royalties”; *Case P* would use “reinvested profits or Directors’ loans; we put it in and then take it out when the business can afford it”; and *Case Q* said “we need finance, but the banks don’t want to help” [*cf.* Woods *et al* (1995)].

Five of the low performers were trying to increase sales rather than control costs [*cf.* Table 6.3], although most agreed that both were important. *Case A* said

“controlling costs is how we survive in this game, and we control our costs extremely well. So extra revenue is more important at the moment”; *Case D* was “looking forward to breaking the £100,000 turnover mark”; *Case E* thought that “controlling costs is difficult to do”; *Case F* had “got the stock there” for sale; and *Case M* said “both are important”. Of those who thought cost control was most important, *Case O* said “if I’m not making much money, I keep my salary down to a basic minimum”; *Case P* thought that “controlling costs is the most important thing with *any* small company; if you’re not making a profit you’re not able to expand”; and *Case Q* said that “you’ve only got a budget to work on, and you’ve got to watch you don’t go over it”.

The low performers had generally experienced funding shortages during the period since start-up, although a few had made some small profits. *Case A* said they were “spending more than we’re earning, and equity has gone up and down”; *Case D* had used “overdraft facilities plus reinvested profits”; *Case E* had “put my own money into the business”; *Case F* had “started with my own money and there’s been no change”; *Case P* had used “our own money, reinvested profits and Directors’ loans”; and *Case Q* had used “our own money for one year; we were under-funded”. Only *Case M* had received much financial support, with loans at preferential interest rates from Shell, the Coal Board and the Enterprise Trust.

This group of firms typically had a short-term view of the finances they would need, looking mainly at cash flow, or back on historical accounts for the month ended, but rarely forecasting ahead: “we see how we did last year at the same time, and try and see patterns when people aren’t spending as much; it’s only kept in our heads, but we look at the bank account” (*Case A*); “I work *all the time* from cash flow, and it’s updated every month without fail” (*Case D*); “Cash flow is the most



important; if you don't have the cash, you can't buy it" (*Case E*); "we tend to look at cash flow mainly; money in and money out" (*Case F*); *Case M* looked at "my sales for the month, and make a graph to chart it; I see what's going in and out and make an educated guess"; *Case P* would "watch the cash flow"; and *Case Q* would "get our accounts done and sit down and compare them with the year before, and keep an eye on cash flow on a weekly basis".

Given that few of the low performers performed any kind of forecasting, advice on this was unlikely to be sought from any of the usual sources for help on working within set budgets. Instead, accountants were used more often to help with tax computations and wage bill calculations: "they would give advice if we asked for it" (*Case A*); "the biggest role is played by my accountant, who tells me how much tax I owe, and how to change or improve the situation" (*Case D*); "the accountant does the wages, and checks the VAT to see I've done it right" (*Case E*); "accountants should play a bigger part, I think, though I don't think it would influence the budget too much" (*Case F*); "the accountant is involved; he looks at our figures" (*Case M*); "I have a friend in insurance who helps a bit" (*Case O*); and "the accountant does the VAT and the yearly accounts" (*Case Q*).

These firms had usually received some small assistance from enterprise agencies, often in terms of the Enterprise Allowance or a start-up grant. However, since this initial help, they had received little else: "we started with nothing" (*Case A*); *Case D* had "not recently" had any grants; *Case E* said that "the Enterprise Allowance was slightly helpful"; *Case F* that "it helped", and that "we tried for new assistance, but because we were vague about employing people, we got no money"; *Case O* had "once approached them [i.e. the Enterprise Trust] for help with advertising, and they said that they had no money left for that"; *Case P* had

managed to obtain “grants for equipment”; and *Case Q* a ‘Headstart Capital Loan’ to spend on a computer. It was again *Case M* that had experienced most help from the Enterprise Trusts, with “one grant for people, and one for the business plan”.

It was not uncommon for the low performers to have experienced difficulties in funding their firm’s operations, with some having had to use their home, or some other asset, as security on a loan, and others putting in their own money, raised, for example, through personal loans or by cashing in insurance policies. They generally seemed aware that it was important to control costs, but were more anxious, at this point, to increase their sales. Low performers did not tend to forecast budgets, but worked instead from daily or monthly cash flow reports. They used accountants, more than anything else, for help with tax calculations and wage bills. They had often managed to get the weekly Enterprise Allowance, but had received little else in terms of money or support from these organisations.

### *Conclusions*

The high performance group of firms were the most likely to think that growth could be financed through the profits they expected to make, but would also be willing to consider both debt and equity investment, if required. They were well aware that cost control was vital if they were to maintain a competitive edge, and they seemed to manage this effectively. The high performers had started with a relatively small equity base, and some had the Enterprise Allowance, but profits had been reinvested, overdraft facilities used, and some substantial subsidies or preferential loans received from enterprise-assisting bodies. They were all *au fait* with the workings of financial and management accounts, using both cash flow and profit and loss accounts on a regular basis, and preparing forecast budgets [*cf.*

Welsh and White (1981)]. They tended to prepare their own budgets, and were not likely to appeal for help on this to either an accountant, bank manager or business advisor.

The medium performers were fairly stable, financially, hoping for profits to reinvest. They appeared slightly more likely than the high performers to want to bring in more equity investment from outside. They were also more likely to want to increase sales than to reduce costs, although again they realised the importance of cost control, and were often taking steps to improve this. Some of the medium performers had been in a position to reinvest profits since start-up, and others had, quite frequently, taken out loans. Some had added more of their own savings, or had even used their own home as collateral for a bank loan. Although some used profit and loss accounts to monitor their firm's performance, they were more likely just to use cash flow on a regular basis. They generally sought advice on preparing budgets, more so than the high performers, and thought that enterprise agencies had been either very helpful, or of no use whatsoever, depending on their personal experience of the Enterprise Trust concerned.

The group most likely to experience financial difficulties was, perhaps not surprisingly, the low performers. Many had access only to their own personal funds, as the banks refused to lend them any money. Most of this group were trying to increase their sales and, although they realised cost-cutting would help, they found it difficult to do. These firms were the least likely to use profit and loss accounts in the running of their business, using only cash flow to monitor their progress, and rarely, if ever, projecting budgets. Accountants were brought in to help with operational procedures such as wage bill and VAT calculations, but not, as with the medium performers, to help forecast or budget ahead for a period.

They had generally found the Enterprise Trusts to be unhelpful, and were the most likely firms to complain about the lack of funding or support they received; although they also appeared to be the least likely to actually seek this support they claimed to warrant.

### *Supporting Evidence*

Supporting evidence on the financial organisation amongst small firms is to be found in the administered questionnaire. When asked to choose between two methods of increasing the working capital in the business, 50 per cent of high performers would rather restructure their debtors' or creditors' payback terms than inject more capital, compared to 40 per cent of medium and 32 per cent of low performers. This supports the case study evidence that higher performers are more likely than lower performers to be able to support growth through internal funding, rather than through further investment.

Methods of restructuring trading accounts included factoring and invoice discounting, which were most likely to be considered by high performers (40 per cent), compared to only 5 per cent of medium and 4 per cent of low performers; possibly because of a lack of awareness of the existence of such possibilities amongst small firms in general, but possibly also because of the high charges levied by these factoring organisations [*cf.* Harris (1993); Hawkins (1993)].

All of the high performers (100 per cent) specifically mentioned that they might seek an extension of trade credit, again supporting case study evidence [*cf.* Case K], compared to 63 per cent of medium and 46 per cent of low performers. The low performers were most likely to try and 'chase up' their debtors more quickly (35 per cent), compared to around one quarter each of medium and high

performers, possibly because creditors were least likely to offer low performers any extension of credit, or leeway in payment terms.

The high performers were the most likely to have received bank finance (60 per cent) [*cf.* Reid (1996b)], followed by medium (49 per cent) and low (47 per cent) performers, but least likely (10 per cent) to have had a loan from friend or family, compared to 16 and 15 per cent of medium and low firms, respectively. No more than 10 per cent of firms overall had friend or family holding an equity share in the business, whilst over 90 per cent of all firms had invested their own money at some point.

In terms of grants, which included subsidies, preferential loans, and the Enterprise Allowance, the high performers were the least likely to have received any (60 per cent), compared to the medium (73 per cent) and low (74 per cent) performers. This perhaps reflects the fact that high performers are those who are more likely to have an idea that will succeed in the first place, are therefore more likely to attract bank support or equity funding, and are less likely to require the kind of support offered by an Enterprise Trust to small firms with little nous or business acumen. This conclusion is borne out by the second year evidence on funding, which shows that 14 per cent of high performers had managed to attract business angel or venture capital investment, compared to a negligible number of medium or low performers (less than two per cent in total) [*cf.* Bhidé (1994)].

In a similar way to the analysis of several variables in Chapter 5, a count, or indexation, variable, *Funding*, was generated to measure the number of sources of funding open to the firm. This variable was the sum of responses to 6 possible

sources of funding<sup>2</sup>, where '1' represented use of that source, and '0' no appeal to the source. The maximum possible value for funding was, therefore, '6', and the minimum, a possible 'zero', though more feasibly, '1'; few firms can exist with no financial injection at all. The proposition to be examined is as follows:

P<sub>6</sub>: those firms with greater access to sources of funding will perform better than those who have fewer sources on which to draw.

Figure 6.1 shows the boxplots resulting from an analysis of *Funding* by performance group. From first glance, it is obvious that each group is very similar, with half of all firms having access to between two and three sources of funding, with a mean value of 2 for the low and medium performers, and 3 for the high performers. Some low and medium performers have access to 4 different sources, whilst there are firms in each group that have used only 1 source to fund their business, most likely, their own cash injections. The cross-tabulated results give some further detail. A high proportion of the low (46%) and medium (59%) performers had used 2 sources of funding, compared to 40 per cent of high performers; and 37.4 per cent of the low performers, compared to 30.6 per cent of the medium and half of the high performers, had used 3 sources. Very few had access to any more funding, and indeed the high performers had used no more than 3 sources in total.

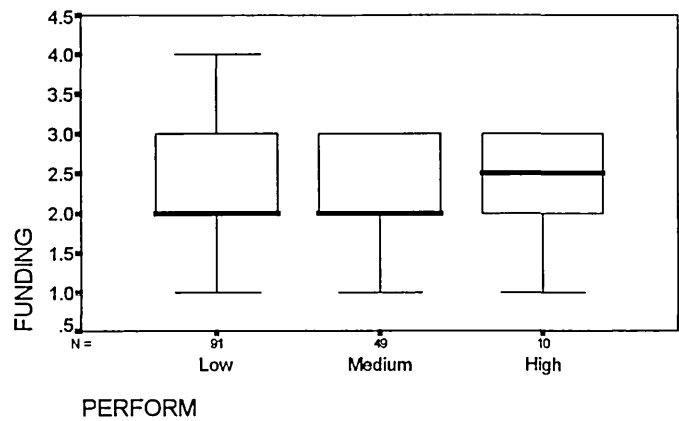
On average, therefore, the high performers have access to slightly more sources of funding than the lower performers. However, the Pearson and Likelihood Ratio tests, and the test for linear association, produce statistics that do not fall in the critical region, so the results are inconclusive, and we cannot accept Proposition 6.

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<sup>2</sup> Personal financial injection, loan from family or friend, family or friend taking 'share' in the business, bank loan, venture capital equity stake, 'business angel' equity stake.

# **BOXPLOTS AND CROSS-TABLUTATION OF NUMBER OF SOURCES OF FUNDING TO WHICH FIRM HAS ACCESS BY PERFORMANCE GROUP**

**Figure 6.1**



PERFORM

Page 1 of 1

FUNDING	Count	PERFORM			Row Total
	Exp Val	1.00	2.00	3.00	
	Row Pct				
	Col Pct				
	Tot Pct				
1.00	9	5	1	15	
	9.1	4.9	1.0	10.0%	
	60.0%	33.3%	6.7%		
	9.9%	10.2%	10.0%		
	6.0%	3.3%	.7%		
2.00	42	29	4	75	
	45.5	24.5	5.0	50.0%	
	56.0%	38.7%	5.3%		
	46.2%	59.2%	40.0%		
	28.0%	19.3%	2.7%		
3.00	34	15	5	54	
	32.8	17.6	3.6	36.0%	
	63.0%	27.8%	9.3%		
	37.4%	30.6%	50.0%		
	22.7%	10.0%	3.3%		
4.00	6	0	0	6	
	3.6	2.0	.4	4.0%	
	100.0%	.0%	.0%		
	6.6%	.0%	.0%		
	4.0%	.0%	.0%		
Column Total	91	49	10	150	
Total	60.7%	32.7%	6.7%	100.0%	

Chi-Square

Value

DF

Significance

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Pearson

6.17549

6

.40382

Likelihood Ratio

8.21965

6

.22245

Mantel-Haenszel test for linear association

1.02531

1

.31126

Minimum Expected Frequency - .400

Cells with Expected Frequency < 5 - 6 OF 12 ( 50.0%)

Interpreting this result, we see that greater access to different sources of funding does not necessarily lead to higher performance. Indeed, it is shown, that the higher performers can often use fewer sources of finance than the lower-performing groups. Of course, in an analysis of this kind, one would ideally be interested in the extent of funding provided from each source, but these data are not currently available in a suitable form for the firms in question. Further work could investigate in greater detail the amount of funding provided from each category, giving a more accurate prediction of performance than does the current model.

The evidence on willingness to dilute equity is relatively inconclusive. Forty per cent of high performers would consider sacrificing a proportion of their stake in the business, or their equity holding, in order to promote growth. Slightly more of the medium and low performers (49 per cent each) would do similarly. This figure is probably higher because the latter were more likely to be in need of extra funding than the high performers.<sup>3</sup> The percentage of equity that each group wanted to retain was between 49 and 53 per cent, on average, with most nominating a desire to retain a controlling share. Compare this with Storey's (1994, p.146) finding that "in all the studies of fast-growth businesses, those which indicated that either they had shared, or were willing to share, equity were more likely to grow or have grown than the businesses which indicated a reluctance to share equity [and] it is clearly the case that growth can be constrained by an unwillingness to share equity".

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<sup>3</sup> However, compare this with the evidence that 14 per cent of high performers had gained business angel or venture capital investment since year one, whereas the medium and low performers had little success in this area. This supports the findings of Reid, Terry and Smith (1997), that acknowledge the efficient 'screening out' of low potential firms by venture capital investors.



Let us now develop and examine a further proposition, in an attempt to find support for the findings of Storey and others. It reads as follows:

P<sub>7</sub>: the greater the dilution of equity that the owner-manager is willing to accept, the better will be performance.

The variable *Stakhold* measures the minimum percentage of equity that the owner-manager would wish to retain, having first admitted a willingness to at least consider equity dilution. This initial screening question meant that, in year one, there were only 73 responses to *Stakhold*, and in year two, 53 responses. It is clear, therefore, that over 50 per cent of respondents in each year were unwilling to given up any share at all of their holding in the business.

For those who *would* sell off a share in the business, in return for equity investment, the results of *Stakhold* by performance group are shown, for each of years one and two, in Figure 6.2. Considering, first of all, the year one data of Figure 6.2a, the first point to note is that most firms wish to retain at least a controlling share of the business (i.e. >50%). For all groups, the median value is just over 50 per cent. The spread of results is similar for low and medium performers, and both have outliers or extreme values ranging from zero to around 90 per cent. Fifty per cent of high performers fall in the range from 50 per cent to about 80 per cent, with the whisker of the boxplot extending down to just under 40 per cent.

Apart from the fact that the high performers' responses are dispersed over a smaller range, in total, there seems to be little clear pattern emerging between performance groups. The Mantel-Haenszel test statistic for the cross-tabulation of

# **BOXPLOTS OF MINIMUM STAKE RESPONDENT WOULD WISH TO RETAIN IN THE BUSINESS BY PERFORMANCE GROUP**

Figure 6.2a

Year 1 Data

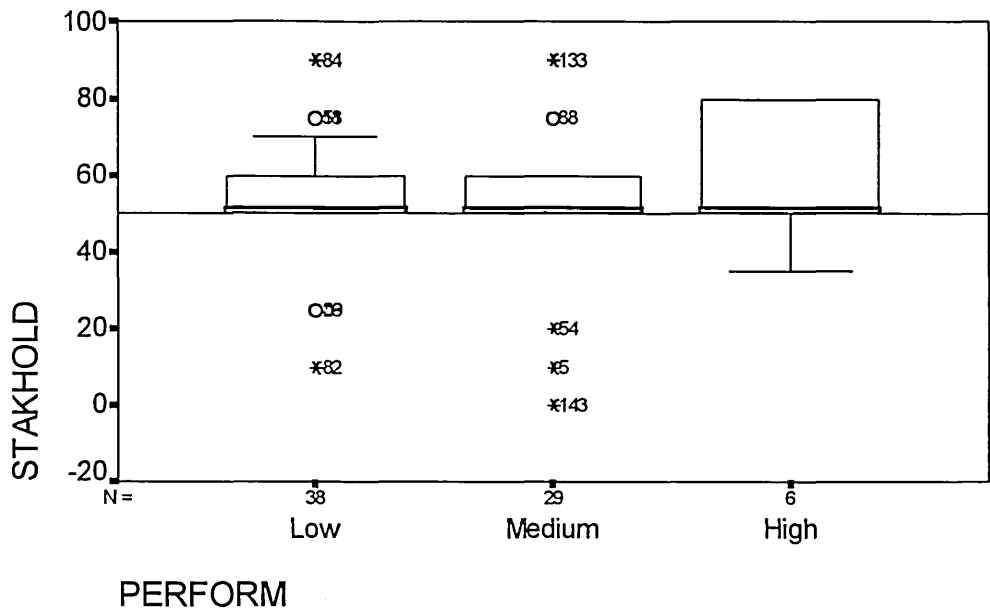
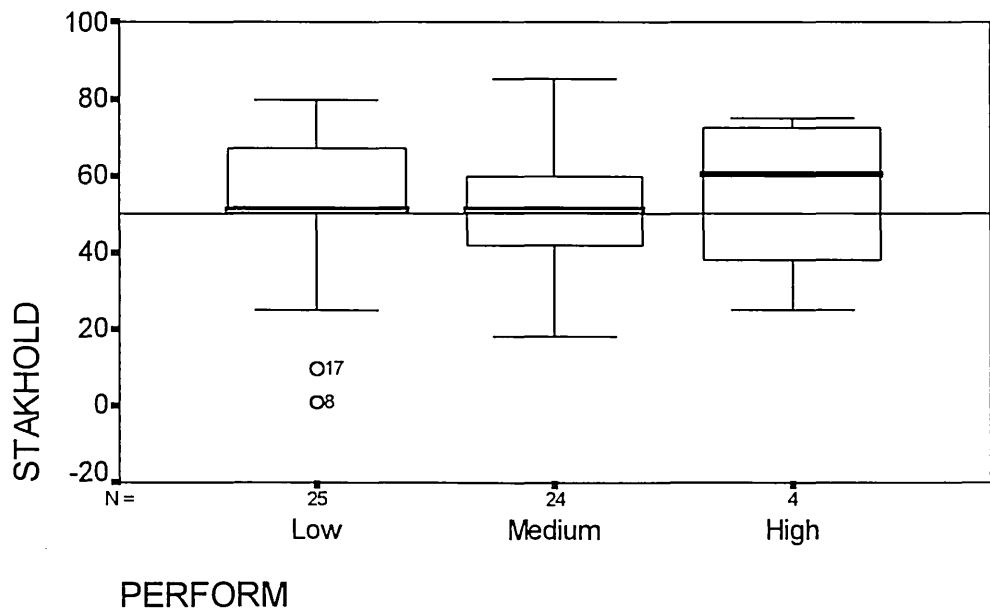


Figure 6.2b

Year 2 Data



*Stakhold* by performance is insignificant<sup>4</sup>, and supports the assumption of no linear association. By contrast, the Pearson test is significant at the 5 per cent level, and the Likelihood Ratio test is significant at the 10 per cent level. This suggests that, for the year one data, there is at least some (although not linear) association between the level of equity dilution an owner-manager would accept, and the subsequent performance of the firm. However, what this relationship might be is not quite clear.

For the year two data, presented in Figure 6.2b, the first point of note is that now only the low performers show outliers, and there are no extreme values. The spread of results for *Stakhold* has narrowed, as the firms become more focused on their goals. It is interesting to note also that part of the boxes of both the medium and high performers now fall below the 51 per cent level representing retained control. This might suggest that we can support the theory that higher performers are more willing to give up a share of their equity holding. However, the median values for all performance groups are still over 50 per cent, and the median value for high performers has even risen, to around 60 per cent. In other words, as the value of the firm has increased, the high performers have become even less willing to give up a share in the business.

For the year two data, the Mantel-Haenszel test shows no linear association between *Stakhold* and performance.<sup>5</sup> Additionally, the Pearson and Likelihood Ratio test results fail to fall into the critical region, suggesting that there no longer exists any association whatsoever. Taking the results from both years together,

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<sup>4</sup> Chi-square test statistics for year 1 *Stakhold* by performance are: Mantel Haenszel test for linear association (0.77298); Pearson (0.0028); and Likelihood Ratio (0.07671).

<sup>5</sup> Chi-square test statistics for year 2 *Stakhold* by performance are: Mantel-Haenszel test for linear association (0.95489); Pearson (0.83635); and Likelihood Ratio (0.83635).

there is very little, if any, evidence to suggest an association between the owner-manager's willingness to dilute equity, and firm performance. The data do not support such an association, and we must therefore reject the assumption of Proposition 7.<sup>6</sup>

Of those firms that would accept smaller profits for a while, if this would help to expand the business (for example, by investing in further assets or human capital), all of the high performers (100 per cent) were in favour of such a move, compared to 92 per cent of medium and 87 per cent of low performers. Again, on a sliding scale from high to low performers, the more successful firms were willing to take less out of the business, or to put more into it, than the less successful firms, who were more likely to want profits, and to want them soon.

### *(iii) Procedures*

The final section under 'Strategy Implementation' looks at the procedures adopted by the firm: in how much detail does it have to clarify procedures, so that everybody knows what to do? [*cf.* Johnson and Scholes (1984, Chapter 11)]. It therefore looks at how new plans are communicated and implemented, in terms of, for example, policy leaflets or procedural manuals. Then it looks at the owner-manager's changing role within the firm, and the impact growth has had upon their job description.

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<sup>6</sup> Compare this with Reid, Terry & Smith (1997) who investigate risk management in the venture capital industry. They show that mere willingness by the entrepreneur to share the equity of his business, in return for a share of the downside risk associated with running the business, does not necessarily suggest a good project. Venture capitalists only invest in a very small percentage of those firms who are *willing* to dilute equity, having first screened out very effectively those they believe will not succeed.

### *High Performers*

New plans were typically communicated through conversations, internally, or using mail-shots or suppliers' literature if the information was going to or came from the external environment. *Case C* would have "conversations and regular meetings with key people", and employees, although sub-contracted, were "firmly within the business and involved in the decision-making process"; *Case K* said that, "internally, we sit down and talk, and externally, we use mail shots, for example, if we had a new product"; and *Case L* said "it's either communicated verbally, or through literature passed on by copying the information from suppliers".

Employees were motivated to adhere to the procedures laid out by various methods, usually financial, and including those discussed earlier [*cf.* Chapter 5: 'policies']. *Case C* said that his employees found it was "a financial motivation for them to be sub-contracted"; and *Case K*, that "if it's more profitable then they get more money". *Case K* also thought that getting people to follow procedures adopted as being 'best practice' was not a problem, because "not many people like to think they're not doing a good job".

The owner-managers of the high performing firms were still involved to some extent in the day-to-day running of the firms, often working longer hour than ever: "I work harder and am still very much involved in the day-to-day running; I would plan to do more managerial things in February and March, when we're not so busy" (*Case C*); "we still do telephone enquiries, but I don't get involved as much in the day-to-day running; we set the deals up" (*Case K*); and "it hasn't changed; it's exactly the same thing, just more of it; I'm working a bit harder now" (*Case L*).

Amongst high performers, new plans and procedures were communicated primarily verbally, with regular meetings and conversations. Employees were motivated to assist in making these procedures successful by financial incentives, through being sub-contracted or involved in decision-making. The directors of these firms were regularly in touch with their subordinates, and some said their roles had not changed, except to become busier; although two tried to make more time for management, strategic planning or 'doing deals'.

### *Medium Performers*

Two of the medium performers, the smaller firms, communicated procedures verbally: "it's informal, as it arises" (*Case J*); and by "conversation, over tea" (*Case N*). However, the remaining four all had very detailed and formal methods for communicating procedures: "we will have a new plan, and always have a strategy meeting with the staff involved who will implement it; part of our success is that we communicate well, about the smallest thing, on a daily basis" (*Case B*); "procedures are written down; each member of staff has his own copy in a folder with their name on it" (*Case G*); "every process is documented on the computer and can be looked up at any time" (*Case H*); and "we have a procedure system, which we've put together ourselves over the last five years". Compare Ansoff (1965, p.119) who believes that, instead of having to make new decisions every time a problem occurs, "a better, and more economical procedure is to prescribe, in advance, the response to be made whenever a specified contingency occurs. This is done through a written statement of the appropriate policy and of accompanying procedures for its implementation. Since the management decision is thus made in advance of the event, a rule for behaviour can be imposed on lower

levels of supervision. Thus economies of management are realized, and consistency of action is assured”.

These firms confirmed their ambition of making sure that everyone knew what was going on, by having available procedures that were well documented and available to all staff. It was thought that such clarity of direction would assist in the implementation of procedures: “we make sure that everyone is happy and knows their role beforehand” (*Case B*); *Case G* would let temporary secretaries see a copy of their procedure manual because “it’s how they know what to do; I couldn’t always tell them”; *Case H* offered no motivation to employees to comply with procedures, because “that’s their job”; and *Case I* had a contract team for each project, who would “meet to discuss the programme, production and cash flow”.

All except one of the medium performers had moved away from the daily running of the business; *Case N*, who still carried out “sales and production and everything else”. *Case B* found that “from the second you start increasing staff, someone has to be the boss”, and so was now playing “a managerial role”; *Case G* was moving “further and further away from the ‘hands-on’” side of the business, and wanted to work purely in sales, spending “all my time in front of customers [because] I love their money”; *Case H* said “my main role now is strategic planning and generating new business”; *Case I*, that “I now spend a lot of time trying to generate new business”; and *Case J* was “trying to step back from the front of shop and become more business-like”.

Most of the medium performers continued their tendency for formality, with written manuals preferred over verbal communication. They used these written documents to help employees become aware of the roles they had to perform, and

hoped that clear communication would encourage their motivation and cooperation. Nearly all of these owner-managers found that their roles had changed quite substantially since start-up. Now, they had distanced themselves from the day-to-day running of the organisation to concentrate on strategic planning and managerial tasks.

### *Low Performers*

The low performers tended to favour verbal communication over written manuals, when it came to procedures, thus conforming with Mintzberg's (1979, p.308) 'simple structure' firms, for whom "informal communication is convenient and effective". For example, "I say, 'what do you think?'" (*Case A*); "We just sit and talk about it, and try and see if it works" (*Case E*); "it's more verbal than anything else, and we do have problems now and again, with communications" (*Case F*); "we tell them something new" (*Case M*); and communications were "typically through conversation" (*Case Q*).

Others, though, did have a slightly more formal procedure, usually when Health and Safety regulations were a concern: "I have an orientation pack for staff [which] sets out our philosophy in dealing with children, risk assessment for each activity, and timetables" (*Case D*); "we have a safety manual which has all the procedures in it; it's for their own safety" (*Case M*); "I'm always getting on to the for Health and Safety" (*Case P*); and "we had a Health and Safety inspector in, who suggested things we had to do" (*Case Q*).

The implementation of procedures was helped slightly by communications, but was not generally a major issue: "seasonal staff are handed a booklet when they arrive" (*Case D*); "I try and keep them in touch with things" (*Case F*); "the author



writes out everything and sends a big book of references” (*Case O*); “they know how I operate and I don’t expect them to do anything to put themselves in jeopardy” (*Case P*); and “we have a partnership agreement” (*Case Q*). Procedural changes amongst the low performers, then, typically came about as the need arose, and were communicated through conversation or by the owner-manager showing staff what to do.

The low performers had not experienced a great change in their position since start-up, although some were beginning to move away from the daily tasks: it hasn’t changed; I’m involved on every level” (*Case A*); “I’ve delegated a lot of the physical work and am doing more administration and marketing” (*Case D*); “I’m still involved in the day-to-day running” (*Case E*); “it hasn’t changed very much” (*Case F*); “we are busier now, we do a lot more admin, and are managers” (*Case M*); “I don’t think it has changed” (*Case O*); “I am doing more on administration, sales and customer relationships” (*Case P*); and *Case Q* said that the partners’ roles “haven’t changed; one does the trophy engraving, and one does the glass and book work and most of the sales”. Compare Mintzberg (1979, p.312), who states that “the chief executive can get so enmeshed in operating problems that he loses sight of strategic considerations”.

The low performers were most likely to have written procedures only when required by Health and Safety regulations. Except for this, procedures were communicated verbally, and employees were either shown how to do things, or expected to know how it was done in the first place. These owner-managers typically found themselves still very much involved on a day-to-day basis, perhaps now working a little harder than previously, but generally carrying out the same tasks. Of those who *had* experienced a change in role, this was often towards a

desk-based position, concentrating on management and administration, and occasionally spending more time on sales.

### *Conclusions*

The high performers were not tied down to strictly enforced procedures, but would use verbal communication on a daily basis to let everyone know what was happening. They would use written documentation whenever the situation warranted it, but did not feel obliged to produce, for example, a set of company 'rules and regulations' to clarify their methods of working. It was not considered too difficult to gain the participation of employees in following company policy, probably because it was not too rigid, but also because of financial motivators [*cf.* Johnson & Scholes (1984, Chapter 11)]. The owner-managers of the high-performing firms still played a high-profile role, being visible daily and still dealing with 'hands-on' work; although they had stepped back, to some extent, from this position, to concentrate more on management, 'doing deals' and making new contacts.

By contrast, the medium performers tended towards a more formal and structured method of communication, often having procedure manuals or policy documents, whether in hard copy form, or available on a computer for ready access, thus following recommendations of the likes of Baker *et al* (1993, p.88) to "distribute condensed plan documentation to all departments for use by all employees". They were very precise, almost clinically so, in making sure that everyone knew in detail exactly what their job was to be, spending time in meetings going over plans for, perhaps, a new project. The owner-managers of the medium performing firms had distanced themselves further than the high performers from

the day-to-day business, in order to spend time mainly on marketing, but also on strategic planning.

The low performers remained relatively informal in their communication of procedures. However, it is to be noted that these firms were the only ones to mention specifically Health and Safety regulations and the impact these had on their businesses. Perhaps their informal structure laid them open to more criticism than, for example, the medium performing firms, who had more formalised procedures that were well-documented and available for consultation at any time. Or, perhaps because this group of firms were so unlikely to have any structured procedures, a visit by a Health and Safety officer, who may have suggested alternative and safer methods of working, was a major event and one they deemed worthy of a mention. This group of owner-managers was the least likely of all the performance groups to have experienced any change in their roles, probably because typically they had not yet grown to the stage where delegation of responsibility becomes an issue. Instead, they found themselves often working harder at the same tasks, perhaps spending a little more time on administration.

### **6.3 Evaluation and Controls**

The final section of the semi-structured questionnaire is related to 'Evaluation and Controls': what are those few key things that will determine whether the firm makes it, and how can it keep track of them? How important is it for management to "gain knowledge of what they realistically can achieve, individually and as a team?" [Thurston (1983, p.180)]. It examines measures of performance and the methods used to describe the success or failure of new strategies, for example, comparing actual with planned performance. It discusses changes in policies based

on the evaluation of performance, or feedback from customers. And it finishes by asking what it is that gives the firm its edge over rivals; what are the unique skills or attributes it has that sets it out above its competitors?

### *High Performers*

Two of the high performers measured the success or failure of new strategies partly in terms of the financial benefits they conferred. *Case C* would ask, “does it fulfil the financial targets and budgets we’ve set, and do people enjoy working here?”; and *Case K* would rate a strategy as being successful “if we made plenty of money; it totally depends on the profitability of the company”. *Case L* said that “I haven’t done anything new”; so evaluation of a new strategy was irrelevant.

The two firms who had used new strategies or implemented new courses of action also had methods for evaluating performance. *Case C* used performance appraisals of his staff, but found that time constraints prevented him from doing as much of this as he would have like to do: “if I have time on my hands I start doing things like that”. On the other hand, he compared financial performance in one period with that of another period: “I plot graphs of growth, for example, this year versus last year”. *Case K* would analyse “the mix for everything, volume and sales”, and set a marketing budget every month. In addition, they would “do a client analysis, which gives us the sales figure per client for 12 product groups, and tells us what we’re doing right and wrong”; and “product analysis using stock reports and gross margin on a monthly and yearly basis”; *Case L*, who had worked in the trade for 20 years, said that “I used to set targets years ago, and I think I *should* set them now”.

All of the high performers said that they had changed policies at some point, based on their appraisal of performance [*cf.* Table 6.4]. *Case C* had “wanted to expand last year, but things didn’t go as well as planned”. In this case, he had “stood back from the situation” to give himself time to think and re-formulate plans. *Case K* had needed to pay off staff: “our company has evolved rather than been pre-planned; it’s grown up and is continually changing; and skills are being developed”. *Case L* thought that it was now “easier to know where I think we should be going”, and had come to realise that “it’s financially beneficial to go down the main contract line, with major contractors, [because] I have a far bigger input on a smaller project”.

When asked what it was that gave their firms the edge over their rivals, the high performers were agreed that the quality and service they offered were superior. *Case C* said “we are friendly, offer one-to-one contact, are flexible and professional, and we care”; *Case K* said “we will go that wee bit further for them, we help them with their cash flow, and we get a plan started for them if they have difficulty paying; it’s a very personalised business”; *Case L* said that “price isn’t as necessary as the quality and service” that his business offered.

Of those high performers who would evaluate new strategies, the key criterion for success was profitability. These firms would set budgets or targets, and compare actual performance against them, in order to measure performance [*cf.* Johnson & Scholes (1984, Chapter 8)]. They had learnt from failure, and changed plans as required, proving that adaptability and flexibility were important to their success. All of the high performers thought that high quality and the provision of a service that went above and beyond that of their rivals were major factors

## INDICATION OF CHANGE OF POLICIES

Table 6.4

	<i>Policies Changed?</i>	<i>Nature of Problem</i>
<b>High Performers</b>		
CASE C	✓	wanted to expand; didn't work; stood back to think and re-formulate ideas
CASE K	✓	paid off staff to lower overheads; company has evolved as it has grown up; continually changing; skills developing
CASE L	✓	financially beneficial to use major contractors as clients
<b>Medium Performers</b>		
CASE B	✗	
CASE G	✓	opened office in London; trouble with local authorities; had to close down
CASE H	✗	
CASE I	✓	changed contract management, to 'go for bust'
CASE J	✓	product lines have not worked; they were dropped
CASE N	✓	stopped advertising in magazines; it was not effective
<b>Low Performers</b>		
CASE A	✓	small scale changes
CASE D	✓	financial constraints; staffing problems
CASE E	✓	changed supplier to one who was cheaper
CASE M	✓	tried to diversify with a new business, but this one suffered so it was stopped
CASE O	✓	little reaction to a new product range
CASE P	✓	changed little things
CASE Q	✓	changed product lines

*Note:* ✓ - yes  
✗ - no

contributing to the admirable performance of their companies.

### *Medium Performers*

Medium performers measured the success of new strategies mainly in terms of an increase in turnover or profits, and by the reaction of customers. *Case B* said “it’s very mercenary; if turnover, and therefore profit, increases; projected targets are set monthly”; *Case G* would ask “does it make any money; cost against return?”; *Case H* said “if it was purely a business strategy, how successful has that part of the business been, compared with the plans we had for it; if it’s a process, has it been a hindrance, or can we see any benefits; is it helping the product, at the end of the day?”; *Case I* said that “the profit and loss account is a measure of our success”, and they used “cost control for each project”, but would also consider the “clients’ reaction and the amount of repeat business” the strategy generated; *Case J* said that “more money coming in as a result, and reactions from the public” were a gauge of success; and *Case N* said “it becomes self-evident”, for example “if an advert brings in new accounts, or I see a great uptake in production”.

These firms very often set targets, either for their products, or for employees. *Case B* did “annual salary reviews and a personal evaluation of each person’s performance”, adding that “team spirit makes success”; *Case G* set targets and said you should “not pretend to yourself”, and “if it doesn’t work, then I’ll close it down”; *Case H* “set targets for employees [and had] annual goals and six-month appraisals”; *Case I* said “every job has an estimated figure; we set up targets and compare with actual”; *Case J* said “each ball-gown has a card, and I enter onto it when it goes out; if it doesn’t go out, it’s a failure”; and *Case N* had “target levels

as far as output is concerned”, and kept “a note of numbers of actual versus budget sales”.

Most of the medium performers had changed policies at some point [*cf.* Table 6.4], because of performance. *Case G* had “opened an office in London to trade with schools”, but had to close it down because of difficulties with the local authorities; *Case I* had “changed the contract management of operations” because they “wanted to go for bust”; *Case J* said “some lines have not worked, and I have dropped them because they have been unsuccessful”; and *Case N* had stopped advertising in magazines because it had not been effective.

The medium performers thought that their staff and the unique selling points, or USP, of their products gave them an edge over their rivals. *Case B* said “it’s all down to staff, and we have the most brilliant team”; *Case G* said it was “me, and the team” who made the business what it was; *Case H* said “we have a better game” that was produced “within the budget set at the start”; *Case I* said that the “quality and service we produce with the CAD facility [is] the best asset in terms of sales now”; *Case J* said it was “the quality of the stock, the friendliness of the staff, the layout of the shop and the way it’s organised”; *Case N* said it was the fact that he sold a “modern, up-to-the-minute product; [and] good quality at a good price”.

Medium performers were most likely to measure success in terms of the profitability of a new strategy, but would also pay attention to the reaction of customers and the effect it had on their organisation or production. This group of firms commonly set performance targets, and would evaluate actual performance against these goals, both in terms of employees’ productivity and product sales. They had often changed policies because of poor outcomes, but seemed to think



that it was better to do that than to persevere with an idea that might not work. Finally, they believed that the team of staff they worked with, and the quality of their product or service, combined to make them better than their rivals.

### *Low Performers*

Low performers often measured the success of a new idea by the reaction it received from customer, or by the fact that they were selling more than previously. *Case A* said success would be “reaching the black in the bank account and starting to build a financial cushion, [having] more personnel, nicer premises and a better wage”; *Case D* measured success by “revenue, and feedback”; *Case E* said “if it sells, it’s a success, if it doesn’t, it’s a failure”; *Case F* said success meant “we managed to increase our customer base”; *Case M*, that it was based on “profitability and the response we get from the clients”; *Case O*, that “I can get work out of it, for example, through referrals”; *Case P*, “if we get repeat business, someone likes the idea, and it makes money”; and *Case Q*, if “customer feedback is favourable”.

The low performers were unlikely to set formal targets or to monitor performance regularly; when targets *were* set, it was often with a vague goal of increasing, or improving upon, the previous year’s turnover. *Case A* said “it’s all held in my mind, we feel the pressure and dig our heels in”; *Case D* said “the full and part-timers have appraisals, but not the seasonal staff”, and he would “compare actual performance with targets and budgets”; *Case E* had a “target sales level over the year; above it equals success, below it equals failure”; *Case F* set “a financial target more than anything else”, and would “not even look back on a certain project; as far as we’re concerned, the job’s done”; *Case M* knew “for

every individual job if it's reached target"; *Case O* said "if it's busy, it's busy, if it's quiet, it's quiet, and there's not a lot you can do about it"; *Case P* would "try to get more work done than the year before"; and *Case Q* would "try to increase over the previous year".

Where changes had been made by low performers, they were more often of a minor nature [*cf.* Table 6.4], and commonly due to the withdrawal of an unsuccessful product range or for financial reasons. *Case A* had made changes, "but only on a very small scale"; *Case D*, because of "financial constraints or staffing" problems; *Case E* had changed to a different supplier for his goods, and thought that "although they are cheap, they are of good quality"; *Case F* was "learning through experience that some things just aren't worth doing"; *Case M* had "tried to diversify [with a] new, but related company", but their present company had suffered; *Case O* had received "not a lot of reaction" on a new product range; *Case P* had changed "little things"; and *Case Q* said that "product lines change, but there has been no change in the job".

Low performers thought that their quality, versatility and the people in their business gave them an edge over rivals. *Case A* said "it must be the quality, and a good price for that quality, because people keep coming back; and personality is important too"; *Case D* thought his comparative strengths came from his "quality, flexibility, adaptability and diversity"; *Case E*, from the "personal service" and a greater selection of stock"; *Case F*, "the experience to do all types of installation work"; *Case M*, "our personal service"; *Case O*, that he was "trying to tackle things that they won't do or can't do"; *Case P*, "myself and my know-how"; and *Case Q*, that "we've got more experience than them [i.e. rivals]".

Low performers measured success or failure by the reactions of customers, or an increase in sales. They usually set a target of improving on previous performance, but were not often likely to carry out formal appraisals or analysis based on actual results. The low performers had made few changes, usually only small, and often to do with a product that did not sell, or because of financial constraints. They often thought that the very wide and diverse range of products or services they offered gave them an advantage over their rivals, as did their personal service and customer contact.

### *Conclusions*

High performers had the most clearly defined measure of success or failure; it would depend entirely upon the profitability generated by a new strategy, meaning not only an increase in turnover, but also in profits, relative to turnover. According to Shuman and Seeger (1986, p.13), "by providing a feedback mechanism management allows for the continuous reappraisal of the company's strategy and the learning and improvement that results from experience in using the process". Medium performers, too, measured success in financial terms, but also by the reaction of clients. And low performers were the most likely to gauge success mainly by the customer feedback generated by a new strategy, or by the fact that a new product would sell.

Of the high performers who had methods of evaluating strategies, these were fairly clear, and involved measuring actual against budgeted or forecast performance, and detailed analysis of sales. Medium performers frequently set targets for employees and sales, and monitored them regularly. Both of the higher performing groups, therefore, adhered to Baker *et al's* (1993, p.88)

recommendation that management should “at least quarterly, check employees’ and organizational units’ performance against the plan”. Low performers were the least likely to set targets or budgets in a formal sense. Instead, they usually wanted just to keep improving, and selling more than previously.

The high performers admitted to having changed policies based on performance, seeing this not as a weakness, but as a sign of their adaptability. Four of the six medium performers had changed things, either policies or product lines, because of their evaluation of performance, although two had not yet seen any need for change. Low performers had rarely changed any policies, with the main changes coming from new or discontinued product lines, or because of financial difficulties.

High performers thought their quality and service gave them an edge over rivals, with personal contact being important. The medium performers thought success came from their staff, and unique attributes of their product or the fact that they offered a better or slightly different good. And low performers thought that their willingness to offer a wide selection of products or to take on any job they were offered earned them more business than their rivals, and hence gave them an edge over competitors.

High and medium performers, therefore, from the evidence discussed above, appeared to think that the evaluation and control of performance was more important than did low performers. They were more likely, too, to have procedures for evaluating performance, whereas low performers would, more frequently, know if something had been a success or a failure because of customer feedback and reactions, or because a new product had sold. High performers were most likely to believe that, if a procedure or policy was not working, then they should change it. Moving down the performance levels, through medium to low, it

becomes apparent that the lower the performance, the less likely are the firms to want to change anything, or to believe that something is amiss with their organisation. Reid and Smith (1996) provide evidence to suggest that, in the early stages of a firm's life-cycle, the self-assessment of the attributes of the firm, by the inexperienced small business owner-manager, can often be badly-judged. The evidence discussed above would appear to support this view.

In terms of the unique skills or attributes that gave firms the edge over their rivals, high performers seemed to think that personal contact and the quality of their product was important. Medium performers appeared to play upon the fact that their service was slightly different to that of competitors. Low performers, however, were more likely to stress that they would do anything, and offered a greater range of goods and services than did their rivals, in the belief that this gave them an advantage over rivals. This belief may be ill-founded [*cf.* Reid and Smith (1996)]; the broad range on offer did not appear to confer any specific benefits, given that these firms were classified as low performers. Perhaps these firms could gain from following the lead of the high or medium performers, in targeting a specific niche market [*cf.* Porter (1980, 1985)], rather than trying to be everything to everyone, as seemed to be their current ambition.

#### **6.4 Summary**

Chapter 6 has dealt with the final two sections of the semi-structured questionnaire, *viz.* 'strategy implementation', and 'evaluation and controls'. Again, the observed tendencies, suggested by examination of the qualitative data, were supported with statistical evidence from the administered questionnaire. Two

propositions were developed and investigated using the methods established in Chapter 5, of boxplots, cross-tabulations and chi-square statistics.

In terms of programmes followed to help the firm achieve its goals, both the high and medium performers were investing in new staff or premises [*cf.* Shuman and Seeger (1986)] and going after bigger jobs, whereas low performers did not have the money for reinvestment, and were trying to improve sales by increasing customer awareness. Firms from all performance groups realised the importance of customer feedback and used it to help maintain and improve quality [*cf.* Thurston (1983)].

On balance, the high and medium performers had experienced some problems in implementing new strategies, often involving staff attitudes [*cf.* Johnson & Scholes (1984)], re-training and organisation. Problems amongst low performers, however, were more likely to be organisational, and related to a lack of finance or space, and failure of new product lines. Constraints on growth for the high performers were self-imposed (if at all) because of uncertainty about the industry in general, but were not due to a lack of finance [*cf.* Bull (1993)]. Medium performers showed a slight reluctance to pursue immediate fast growth, but were also constrained in part by a lack of finance, staff or time. Low performers, on the other hand, found financial constraints to be a major barrier to growth.

In terms of budgets for growth, high performers were to finance expansion primarily through reinvested profits [*cf.* Bhide (1994)]. Medium performers, too, hoped to be able to do similarly, but would also consider equity investment. Low performers were unlikely to generate much profit for reinvestment, had difficulty in getting access to bank funds [*cf.* Woods *et al* (1995)], and were often reliant upon their own personal funds. High performers emphasised the importance of cost

control [*cf.* Porter (1985)], as did medium performers, although the latter were more likely to want to increase sales. Low performers were split on this, but said that it was difficult to do anything about cutting costs.

High performers used management accounting systems and kept a regular eye on cash flow, dealing with this in-house [*cf.* Thurston (1983)]. Medium performers also kept profit & loss accounts, but were more likely to concentrate on cash flow [*cf.* Welsh and White (1981)], and to seek outside advice on preparing budgets. They were most likely to seek advice on organisational features such as the calculation of wage bills and taxation, rather than for strategic planning.

Proposition 6 investigated the assumption that access to more sources of funding will be reflected in better performance. It is shown that, although the high performers have, on balance, access to slightly more sources than medium or low performers, this difference is not a significant factor in predicting performance. A further proposition is developed to examine the assumption that the willingness to accept greater equity dilution will lead to enhanced performance [*cf.* Storey (1994)]. Again, this assumption is not confirmed; the evidence on willingness to dilute equity shows a non-linear association with performance in year one, and no association whatsoever in year two.

Procedures amongst high performers often involved meetings with staff and their involvement in decision-making, but were not generally laid down in leaflets or manuals. Medium performers were more likely to have formally documented procedures [*cf.* Ansoff (1965); Johnson & Scholes (1984)]. Low performers discussed new procedures as they arose, usually through an informal conversation. Motivation for the employees of high performers to adhere to procedures was usually financial. For medium performers, it often involved making sure that

everyone was clear about their role, and that lines of communication were kept open. Low performers would communicate new procedures verbally [*cf.* Mintzberg (1979)], and kept employees aware of new ideas, in an effort to encourage their participation.

The high-performing owner-managers still made sure they were involved in the daily running of the business, and often were spending more time than before on additional tasks such as management or planning. The medium performers were more likely to have distanced themselves from the day-to-day work, concentrating on strategic planning or sales. Low performers found that their roles had changed very little since start-up, although there was more administration to do.

Under evaluation and controls, high performers measured success or failure of a new strategy in purely financial terms, by whether or not it reached the target set. Medium performers, too, used financial indicators, but also judged success by the reaction of customers. Low performers concentrated on customer reaction, and whether a new strategy helped to increase sales, in a vague sort of way.

High performers would sometimes set targets, both for the business and for staff, and would carry out performance evaluations on each [*cf.* Johnson & Scholes (1984)]. Medium performers regularly set targets and compared actual performance against these targets [*cf.* Baker *et al* (1993)]. Low performers, however, set rather intangible targets, if at all, such as growth, or improving on turnover. They were unlikely to carry out any formal analysis of performance in the same way as the medium or high performers.

Nearly all firms had changed tack at some point because of the failure of an idea or policy. For high and medium performers, these often involved strategic change, whereas for low performers, they were more likely to be small scale or operational



changes, probably because these firms were least likely to try new strategies in the first place.

Finally, high performers thought their quality and personal service differentiated them from their rivals. Medium performers thought similarly that their staff and the better quality of products gave them an edge over rivals. Low performers were agreed that their quality and personnel distinguished them from rivals, and also mentioned their versatility and adaptability as being good selling points. Although they appeared to think that their strengths were as good as, or better than, competitors, this was not reflected in performance.

Overall, a picture is emerging of distinct differences between the low, medium and high performers, in terms of the strategies adopted. High performers seem to be aware of formal methods of strategic planning, but do not allow themselves to get so snowed under that they neglect the actual running of the business [*cf.* Mintzberg & Quinn (1991); Bhidé (1994)]. Medium performers try very hard to follow the textbook forms of strategy, having often very detailed and formal processes, and trying to follow forms of hierarchy, delegation and management suggested in the literature as 'best practice'. Low performers, on the other hand, have little, if any, idea of strategic planning, being concerned often with only operational problems, and thinking no more than a month or two ahead. Chapter 7 will now draw together the conclusions from the full study, to try and establish characteristics of each performance group, in terms of their strategic planning and processes.

# Chapter 7

## Conclusions

### 7.1 Introduction

A key aim of this work has been to advance the literature on small business strategy through, first of all, an appraisal of the existing work in the area of strategic management, as it relates to both the large and small firm. It then introduced a new instrument designed to gather quantitative evidence on 150 young small firms in Scotland. Additional qualitative evidence was gathered using a specially designed semi-structured questionnaire to investigate in-depth the strategies pursued by small firms.

The investigation of the extant literature was split into two parts. First, there was a discussion of the earlier works, which were concerned primarily with corporate strategy. A distinction appeared between those who advocate formal strategic planning [*cf.* Ansoff (1965); Porter (1980, 1985)], compared to those who believe that intuition and anticipation play a more important role [*cf.* Mintzberg (1979); Steiner (1979)].

The second part of this review examined the emerging literature on strategy, as it relates specifically to the small firm. It looked first at the processes of decision-making within small businesses, and the role of the owner-manager's goals and objectives in making these decisions [*cf.* Bamberger (1983); Miller and Toulouse (1986)]. Next, the role of forward planning was investigated for the case of the small firm. The literature was found to be divided on the issue as to whether small

firms should (and indeed are able to), or should not, plan ahead [*cf.* Welsh and White (1981); Thurston (1983)].

The question of sources of funding for small firms has received probably the most attention in recent years [*cf.* Welsh and White (1981); Bull (1983); Jarvis *et al* (1996); Reid (1996a,b)]. This is one of the most important issues facing a small business, so a considerable amount of time and effort has been devoted to investigating liquidity constraints, and methods of overcoming them. Again, views differ as to what constitutes best practice, be it, for example, factoring the firm's debts [*cf.* Harris (1993)], taking on further investment [*cf.* Bull (1993)], diluting the owner-manager's equity holding [*cf.* Storey (1994)], or varying the number of part-time employees [*cf.* Reid (1996a)].

The review of the literature continued by looking at the possibilities offered by new technologies [*cf.* Porter and Millar (1991)]. It is thought by some [*cf.* Cooper *et al* (1991)] that technology can help firms to differentiate their products in ways that were not possible previously. However, others suggest that, rather than innovating themselves, many small firms are free-riding on the technologies of larger competitors or parent companies [*cf.* Variyam and Kraybill (1993); Reid, Siler & Smith (1996)].

The final consideration of the small firm literature examined systems of quality control and the analysis of strengths, weaknesses, opportunities and threats. It introduced recent techniques in management accounting, such as total quality management systems, which suggest that procedures for maintaining quality be implemented [*cf.* Hanks (1993a)]. The literature implies that a knowledge of the firm's strengths and weaknesses will assist the owner-manager in positioning the

business so as to gain the best possible competitive advantage [*cf.* Madu and Kuei (1993)].

Some recent works on small business development have emphasised the stages through which a new and growing firm must pass, from start-up, through survival and growth, to expansion and, eventually, maturity [*cf.* Churchill and Lewis (1983); Mount *et al* (1993)]. However, these works have developed from an analysis of the existing literature, and are without specific empirical foundation. Perhaps the inability of writers to agree upon the strategy processes followed by new small firms, especially micro firms, has arisen because of a lack of hard facts and evidence. What is required is a cohesive programme for investigating what actually happens in the new small firm. Theory may be useful in developing hypotheses about the pattern of behaviour in the new small firm, but without grounding this theory in empirics, it may be difficult to draw any concrete conclusions or to prescribe new policies.

This study has developed a methodology for gathering fieldwork data, based on techniques employed in earlier studies [*cf.* Reid (1993)]. A new administered questionnaire was designed specifically to address the questions and conflicts which are raised in both the earlier and more recent literature. Face-to-face interviews were held with the owner-managers of 150 small firms throughout Scotland, for each of two years, to generate a unique source of data on the experience of new enterprises in Scotland in the early 1990s. A new database was designed to store and process the information thus gathered, which provided an original body of evidence on which to base results.

In addition to the administered questionnaire, a new semi-structured interview schedule was designed to question owner-managers on their strategies, while

giving them the opportunity to talk about what they actually do in some detail. A novel twist was to introduce answers previously given in the administered questionnaire, in order to probe the respondent further on his earlier responses and changes since these had been given. These semi-structured interviews enabled the development of 17 case studies [*cf.* Appendix IV], which examine in detail the strategies followed by new small firms.

Having established these two unique bodies of evidence, an original method was developed of ranking the firms by performance. Instead of adopting common techniques of a one-variable measurement such as, for example, turnover, profits or asset value, this method used three indicators of performance. The units of measurement were growth (defined as the percentage change in employment), return on investment (in terms of net profit divided by owner-manager's initial cash injection), and productivity (being sales per head). Cluster analysis was used to divide the 150 firms into three groups of low, medium and high performers, whose strategies could then be observed by reference to both the quantitative and qualitative evidence.

The substantial analysis of the evidence is contained in Chapters 5 and 6. These examine in great detail the strategies followed by firms in each performance group. They make appeal primarily to the case study evidence, but support the observed tendencies with statistical analysis, using quantitative data on the full sample of 150 firms. Seven propositions are developed and investigated, with the help of boxplots and cross-tabulations, to compare performance with specific actions. Chi-square tests of association are used either to accept or reject the assumptions behind the propositions, which add further support to the findings.

The remainder of this chapter will proceed, first, by encapsulating the earlier analysis of this work in sharp characterisations of each performance group. This will present the most important points noted from the investigation. Key characteristics will be summarised in three separate tables for each performance group, in turn. There will then be presented a set of prescriptions, based on evidence of the best courses of action to take for high performance, followed by suggestions as to what can be done by support agencies to assist small firms.

## **7.2 High Performers**

If we refer to the dendrogram of Figure 4.3 [*cf.* Chapter 4, p.168], we observe that the first major split of firms is between high performers and the rest. What, therefore, distinguishes these exceptionally well-performing businesses, in terms of their strategies? Let us summarise the evidence on the characteristics of high performers.

### *Environmental Scanning*

The high performers know the industry well, keep to a local or (at most) Scottish market to retain firm control, and price at a level that means they are competitive with rivals. They aim to provide a high quality product or service, and rely on good relationships with suppliers to ensure, in turn, a good relationship with their customers. Most started the business in order to exploit a new market opportunity or to get rich. They also display a high need for achievement and a wish to be their own boss. These findings suggest that the owner-managers chose to go into business on their own, rather than being forced into it through, for example, unemployment.

These firms appear to have the most realistic appraisal of their own strengths and weaknesses, the former relating to the quality of staff, and the latter to problems of organisation and lack of suitably skilled staff. They use marketing to advertise their strengths, and have actively worked to remedy their weaknesses, investing in new skills, resources and systems. They are also aware that their product quality and staff competencies offer them opportunities. They take advantage of such opportunities, for example, encouraging skilled staff to innovate and develop their unique skills or competencies [*cf.* Kay (1993)]. High performers are astute enough to realise that the largest threats come from the competition, so they focus their business to operate in a specific niche [*cf.* Porter (1980, 1985)], trying to beat rivals on price, quality or both.<sup>1</sup>

The emerging assumption that high performers know most about the environment in which they operate is supported by the qualitative evidence. The majority actively gather information on their rivals, on average every 10 weeks. This covers rivals' marketing, products, financial performance, market share and personnel, and is gathered primarily through newspapers, trade journals and 'the grapevine'. However, they often also use electronic databases, government publications and library sources. It is shown [*cf.* Chapter 5: Environmental Scanning] that greater gathering of trade intelligence on rivals is in some measure related to better performance.

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<sup>1</sup> See also Reid's (1993, Chapter 7) discussion à la Porter on competitive and defensive strategies for small firms in fragmented markets.

### *Strategy Formulation*

Of those high performers who have a business plan, it has usually been developed through their own initiative and is used in the running of the business to keep the firm on track. Only one third have used external sources of advice to help develop the plan, usually appealing to family or friends for their thoughts or ideas. They show a good ability to develop their own ideas, and have a useful network of people ready and able to discuss suggestions. These firms set strategic objectives of long-term profit and a high rate of return, both for personal financial stability, and to generate employment [*cf.* Storey (1994)]. They also have the longest planning horizons of any performance group working, on average, to a two-year plan.

High performers have a clear idea of what they want to achieve, and the means by which they wish to do it. They do not typically generate a so-called 'menu' of strategic options, as they tend to be already firmly focused. Any new ideas depend primarily on the prevailing market conditions. These firms often consider the experience of other firms when making their own strategic decisions. They also seek outside advice on new investment, for which a high proportion are willing to pay. Advice on personnel and marketing is also sought by high performers. These three considerations (*viz.* new investment, personnel, marketing) are all relevant to a growing firm that may require skills not already in place in the business. The willingness by high performers to seek advice on strategic matters, when needed, and, often, to pay for it, reflects their awareness of the importance of having accurate and professional advice and judgements, where necessary.

Amongst the high performers, the owner-managers are still very much involved in making decisions, with most being made by one person only. In addition, the



majority of operational decisions are made by one person, reflecting the high performers' attitude of just getting on with the daily work, without becoming embroiled in too much formal discussion. These businesses try to retain long-standing customers, and also to attract new customers, by advertising, maintaining a high market presence and through differentiation of their product or service.

The high performers believe, on balance, that information technology is very important to their business for the advantages it gives over competitors, but this belief is shown not to be a good indicator of performance. Instead, the actual use of IT is measured and judged to be of high statistical importance. The high performers make most use of IT, in particular being the only group to extend IT usage to a combination of radio communications, satellite links, telephone conferencing and microfiche. They use it for networking and tracking competitors, as well as for producing accounts. This supports the findings of others [*cf.* Porter and Millar (1991)] that the seeking of knowledge confers competitive advantage, and that IT can assist in this process.

High performers address any problems in quality through additional training. They try to ensure quality by regular monitoring and inspection, and through spot-checks. Some have implemented their own quality procedures or recognised systems such as ISO9000. They give customers guarantees or promises to replace faulty goods, and try to ensure their satisfaction by guiding them to a suitable product for their purpose, while also relying on their reputable track record to clinch the sale.

Staff of the high performing firms are often thought to be self-motivated. However, these firms also offer employees additional motivation. First, they are encouraged in their work, and invited to participate in decision-making, developing

a good working relationship with the owner-manager. But most important, these business owners recognise that money is a highly effective motivator, so employees are offered incentives in terms of commission and bonuses.

### *Strategy Implementation*

The high performers both recognise that, to implement new strategies, they must invest in staff and premises, and seek larger contracts and new business, and have been successful in doing so. They use customer feedback to improve quality. Where problems have been encountered in new strategies, they have often struggled through to make them work, using advertising and cutting prices if necessary. They like to be sure that a new strategy has a high probability of success before committing themselves to it, making sure that the required staff and resources are in place beforehand. However, once committed to a new plan, it is important to them to put it into action very quickly, and to follow it through whole-heartedly. Major constraints on growth lie with the current market situation, or a lack of consumer spending, rather than a lack of funding.

These firms expect growth to be financed from reinvested profits. They are very careful to control costs in order to try and achieve improved margins and profitability. Financial inputs since start-up have come mainly from reinvested profits or loans from the banks and Enterprise Trusts. High performers are the most likely group to consider change, in terms of restructuring their finances, for example, by factors or invoice discounting. They generally deal with all budgeting and financial management in-house, enabling them to know, at a glance, what their cash flow is like.

Verbal communication of procedures is prevalent among high performers, who have regular meetings with key people in the business. The involvement of the staff in this way is thought to be enough to encourage them to participate in the firm's procedures. The productivity bonuses to be achieved by adhering to procedures also means that they earn more money if the firm is profitable. The owner-managers are still heavily involved in the daily running of the business, showing a high commitment that is appreciated by staff.

### *Evaluation and Controls*

High performers set targets and evaluate new strategies on their financial success, or failure. They often use quite sophisticated methods to do this, having graphs to compare periods, measuring both volume and sales mix and variance, carrying out staff appraisals and performing client analyses. In addition, they use stock reports and both monthly and annual management and financial accounts.

These firms change policies based on performance when it becomes evident that the strategy is not a viable proposition at that time. On such occasions they take time to reflect on what has gone wrong, and place a great emphasis on learning from experience. They accept on-going change and development as a fact of life, and recognise the need to develop skills. Their personal service and quality is thought to be the most important factor in attracting and keeping customers, rather than the price they offer.

## **7.3 Medium Performers**

The next split of firms, again by reference to Figure 4.3, is between medium and low performers. The medium performers account for one third of firms in the

sample. Let us now examine these businesses by summarising the evidence available.

### *Environmental Scanning*

Medium performers have often seen a gap in the market (for which areas differ, depending on the firm), or have acquired previous experience in the industry working for someone else, before deciding to start their own business. Their prime reasons for start-up were to satisfy a need for achievement or to avoid unemployment. The majority gather trade intelligence on rivals, with newspapers, trade associations and trade journals being important sources of such information. However, this is done to a lesser extent than is evident amongst the high performers. Quality is generally high, and prices are based on a need to cover costs, but are also, to some extent, based on rivals' actions.

These firms are generally happy with suppliers, and with customers. They are sure of their strengths, which lie in their quality and specialist knowledge, and weaknesses, which come down to a lack of funds, poor management and bad planning. They know opportunities lie with their staff, who are developed through training, and their ability to provide customised products. Threats are not always acknowledged; rivals are often ignored, and government legislation, by-laws and Health & Safety legislation are thought to be amongst the major threats.

### *Strategy Formulation*

Medium performers typically have formal, written business plans, which analyse markets, staff levels, and required premises, and also contain financial forecasts. Seventy-five per cent seek outside help in preparing their plans. These firms aim to

provide a quality product at a profit, but also seek a high rate of return and increase in their customer base. They formulate goals of growth to enable them to step back from the day-to-day running, but also think that it is important to do the best they can and achieve the goals they have set.

These firms generate strategic options, using outside advice to help in their evaluation, and computers to generate return on investment calculations to assess their viability. Decisions are based on market information, the owner-manager's specialist knowledge and his or her perception of consumers' spending power. Strategic decisions take into account the experience of other firms for just over half of medium performers. Just under half say strategic decisions are made by only one person. If medium performers seek outside advice, it is usually on investment or marketing, followed by personnel matters. They often hold regular Board, management and staff meetings to make decisions. These firms show a strong tendency for regular and detailed discussion of any plans before decisions are made. They rely on their quality and PR to keep the customers they have, and on word of mouth or referrals to get new customers.

Information technology is thought to be moderately to very important amongst these firms, because of its speed, accuracy and labour-saving possibilities. They use mainly PCs, faxes and mobile phones, and are the highest users, on average, of electronic mail. IT is used for networking and keeping accounts. Although these firms think IT is important to their firm, its actual use was less than for the high performers.

Medium performers maintain an awareness of the market to ensure quality is kept up to standard. They also have regular monitoring, checking and quality assurance systems. These owner-managers try to assure customers of quality by

their honesty, and some give guarantees. They try to ensure employee motivation first, by getting them involved in decision-making, and making them feel they have a share in the vision of the business; and second, often by offering financial motivators such as non-contributory pension schemes, company cars and profit-related bonuses.

### *Strategy Implementation*

Medium performers have made investments to help them achieve growth, taking on new contracts and additional staff, and improving their fixed assets. They all receive feedback, most of it asked for. The majority are willing to make changes based on this feedback, and they also use it for motivation of employees. A substantial proportion have experienced problems, because of factors associated with time constraints, inappropriate organisation and a lack of suitable staff. New strategies tend to be dictated by market conditions, but if a new idea is decided upon, it is generally thought important to implement it quickly. Constraints on growth lie with staff shortfalls, slumps in trade and lack of finance.

Medium performers reinvest profits and also, in some cases, have managed to attract additional investment in both debt and equity form since start-up. Most are focused on increasing sales rather than cutting costs, although they recognise the latter is important. They often seek outside advice when formulating budgets, from accountants, Enterprise Trusts, and bank managers. These firms typically prepare full management accounts, generating management reports and cost analyses, while looking at cash flow on a daily basis.

Medium performers use formal communications, often having their own written procedure manuals. Strategy meetings are held, and staff are given their own

copies of procedure manuals to try and encourage their participation in working towards the firm's goals. The owner-managers of these small firms have typically moved away from the day-to-day running of the business to concentrate their efforts on management, sales, generating new business and strategic planning.

### *Evaluation and Controls*

To medium performers, the success of a new strategy is measured by customer reaction, and by its effect on turnover and profits. They set targets for both products and employees, carrying out detailed evaluations of estimated figures compared with actual performance. They change policies following failure of systems, or of new product lines. Their staff and product quality are thought to be their strongest points when trying to attract new business.

## **7.4 Low Performers**

Although this final group of firms contains the lowest performers in the sample, it is important because it accounts for almost two-thirds of the businesses in the study. Why are the majority of firms performing at a level which is much lower than the rest? Let us now examine their strategies in the search for enlightenment.

### *Environmental Scanning*

The owner-managers of low performing firms were often pushed into self-employment through redundancy or unemployment. Many express a need for achievement or to be their own boss, and some started the firm to profit from a hobby. Very few, however, expect to get rich from running their own business. It

is apparent that lifestyle goals are therefore very important to the owner-managers of these small firms.

Quality is ideally good or high, but can be variable. Price is derived from unit cost plus a mark-up percentage, and is not often based on what competitors are charging. These owner-managers work primarily in a local or regional market because they know it best and it is convenient to do so. Often, the market niche is not specifically targeted, so it is defined by the area from which the customers just so happen to come. This group of firms are the lowest gatherers of trade intelligence on rivals, learning less than the higher performers about rivals' finances, market share, marketing and personnel matters of competitors. Low performers are generally happy with their suppliers, although unable to bargain any more effectively than rivals over price. They typically say that the customer relationship is also good, and depend upon word of mouth and referrals for a large part of their business.

These firms are able to identify their strengths as being the quality of their product and staff, and the personal service they offer. Opportunities are thought to lie in their quality, adaptability and flexibility. They are hard-pushed to admit to any faults in themselves or their operations, seeing weaknesses instead as being a lack of finance, suitable premises, machinery and staff, or the small share they have of the market. Threats are perceived to lie with rivals' market share and government legislation. The low performers show a strong tendency to over-estimate strengths and opportunities, and to under-estimate weaknesses and threats, as reflected by their poor performance.



### *Strategy Formulation*

These firms usually have a business plan of some sort but, by the time of their interview, only a small proportion of these are formal and written, or current. They look up to 14 months ahead when planning. Personal issues are an important issue to the owner-managers of these firms, who often want simply to earn a living for themselves and their family. Their main aim is survival, and most hope to grow the business on. This is measured by their having more work, a higher turnover and greater profit. Their goals are mainly personal, and for family security, and only a tiny proportion hope for a high rate of return. These owner-managers are therefore motivated not by the thought of a large future income, but rather by the need to provide for their family. They rely on customer loyalty and good relations with them to keep work coming in. They often fear confrontation and so do not actively seek to take customers from rivals.

Most low performers say they do come up with various strategic alternatives, which they decided between over casual conversations. In reality, these may not be viable strategic options, but simply ideas that sound good at the time, as it seems that low performers have many more ideas than are implemented. A new plan is put into action if it looks like it might make money and the business can afford to fund it.

These firms are most likely to use outside help or advice for planning, for example, from their local Enterprise Trust. Strategic decisions are mostly negotiated. They are also most likely to seek advice on marketing, but not as willing to pay for such advice. Although, therefore, they see a need for professional advice, their unwillingness to pay for it shows a lack of commitment to getting things right.

Low performers appear to think that information technology is moderately important to their firm, but their actual implementation of IT is lower than both the high and medium performers. They use mainly telephones, faxes and PCs. They are the most likely of all performance groups to use the PC for their business plan, probably because that is how the Enterprise Trust shows them to do it. And they are the least likely to use IT for networking, preferring to work in the dark as regards their environment and competition.

These firms are the least likely to have formal quality systems, relying instead on their own judgements as to what is right, with occasional spot-checks. They tend only to give a guarantee if it is requested, and prefer to use verbal reassurance. Any employees are motivated through encouragement, and the easy-going atmosphere in which they work. They are not heavily involved in decision-making, although they may be consulted for an opinion.

### *Strategy Implementation*

Few of the low performers have anything to reinvest in their business, although one or two are trying to increase staff and improve their equipment. They hope that growth will occur through new contracts and new product lines, and try to increase customer awareness through marketing and cold-calling. Positive feedback is used as an advertising tool, and negative to try and improve the product or service. Most of these firms experience problems, usually associated with a lack of money, time and staff.

A lack of funds is seen to be the major constraint on growth. These owner-managers would like to get bank loans, or to make enough profits to reinvest, but are usually supporting the business from their own personal sources. The majority

want to increase sales rather than cut costs, because they find it very difficult to achieve the latter. They use cash flow to assess their financial situation, and look back on performance about one month. They are unlikely to perform forecasts or budgets, and find accountants of most help when preparing wages and tax calculations.

Communication amongst the low performers tends to be verbal, except on matters of Health & Safety, where leaflets or pamphlets are provided to show advised procedures. Change occurs as and when needed, and employees are told or shown what to do. These owner-managers have experienced very little change in their own role. They are now busier, doing more administration and marketing, and have, in some cases, taken on a more managerial role.

### *Evaluation and Controls*

Low performers measure the success or failure of a new idea by the customers' reaction, or an increase in sales. There are no formal targets set, except to improve, in general, and performance is not typically monitored. Changes are minor, if they occur at all, and tend to relate to new product lines, or to arise from financial considerations. The owner-managers of these firms believe their quality, versatility and staff to be of most importance in gaining custom over rivals.

## **7.5 Prescribed Strategies for Growth and Success**

The preceding sections have drawn together the findings on each performance group. From the analysis throughout this study, eleven key factors emerge, and these are summarised for high, medium and low performers in Tables 7.1, 7.2 and

## STRATEGIC CHARACTERISTICS OF HIGH PERFORMERS

**Table 7.1**

Factor	Characteristic	Details
1. Awareness	<i>very good</i>	knowledge of industry; aware of strengths, weaknesses, opportunities & threats willing to pay for advice gather trade intelligence
2. Objectives	<i>clearly defined</i>	niche invasion cost & differentiation focus strategic objectives long term profit and high rate of return beat rivals on quality and price
3. Targets	<i>quantifiable</i>	long time horizon financial targets comparison of forecast with actual variance analysis
4. Decision-Making	<i>efficient</i>	owner-manager heavily involved in strategic and operational decisions account taken of employees suggestions
5. Policies	<i>adaptable</i>	learn from experience willing to change
6. Commitment	<i>high</i>	believe it important to follow ideas through reinvestment of all profits still involved daily
7. Motivation	<i>high</i>	financial bonuses and commission most important non-pecuniary benefits staff involved in decision-making made to feel part of a team
8. Quality	<i>high</i>	maintained through regular monitoring and training own or approved systems rely on personal service
9. Communications	<i>quick &amp; concise</i>	verbal meetings as required with key personnel
10. Information-Technology	<i>exploited</i>	heavily used well implemented
11. Finance	<i>healthy</i>	reinvestment of profits in staff, premises and assets cost control a priority accounts dealt with in-house

## STRATEGIC CHARACTERISTICS OF MEDIUM PERFORMERS

**Table 7.2**

Factor	Characteristic	Details
1. Awareness	<i>moderate to good</i>	previous experience in industry know strengths, weaknesses and opportunities not very aware of threats gather trade intelligence analyse markets seek advice on investment and marketing
2. Objectives	<i>fairly clear</i>	avoid unemployment and need achievement high rate of return and increase in customer base want to achieve goals set strategic options
3. Targets	<i>quantifiable</i>	measured by customer reaction, turnover and profits targets set for products and employees detailed evaluations estimates versus actual
4. Decision-Making	<i>formal &amp; laborious</i>	outside advice, personal computers and market information used project return on investment more than 50% of strategic decisions negotiated Board, management & staff meetings formal discussions
5. Policies	<i>adaptable</i>	willing to change market conditions dictate
6. Commitment	<i>moderate to high</i>	important to achieve goals set reinvested profits move away from daily work
7. Motivation	<i>high</i>	involved in decision-making share future vision of the business financial motivators include pension schemes, company car, profit related bonuses
8. Quality	<i>high</i>	keep aware of market regular monitoring, checking, quality systems assure customers through honesty and guarantee
9. Communications	<i>formal &amp; structured</i>	formal, written procedures manuals, regular meetings strategy meetings
10. Information-Technology	<i>well used</i>	moderate to very important use PCs, mobiles phones, fax and email frequently for networking and accounts
11. Finance	<i>adequate</i>	reinvested additional debt and equity full management accounts prepare budgets with outside help look at cash flow daily

## STRATEGIC CHARACTERISTICS OF LOW PERFORMERS

**Table 7.3**

Factor	Characteristic	Details
1. Awareness	<i>poor</i>	gather the least trade intelligence of all firms can identify strengths and opportunities reluctant to admit weaknesses tendency to both over- and under-estimate strengths, weaknesses, opportunities & threats, in general least likely group to network
2. Objectives	<i>personal</i>	avoiding redundancy and unemployment want to achieve, be own boss, profit from hobby lifestyle goals main aim is survival
3. Targets	<i>vague</i>	shortest time horizon vague target of overall improvement evaluated on customer reaction
4. Decision-Making	<i>informal</i>	casual conversations depend on financial situation at the time discuss long-term decisions with others
5. Policies	<i>not defined</i>	little available to reinvest for growth rely on marketing and cold-calling no formal quality system take things as they come
6. Commitment	<i>moderate</i>	owner-manager busier more administration and some delegation finance through own resources often unwilling to pay for professional advice
7. Motivation	<i>moderate</i>	owner-manager's need to provide for self and family staff given encouragement easy-going atmosphere few (if any) financial rewards
8. Quality	<i>variable</i>	ranges from low to high least likely to have formal quality systems rely on own judgements some spot checks verbal reassurance rather than guarantee
9. Communications	<i>informal</i>	verbal except for Health & Safety staff told or shown what to do
10. Information-Technology	<i>not used extensively</i>	believe IT is important, but not shown in actual use lowest users of IT of all performance groups phone, fax, PCs
11. Finance	<i>insufficient</i>	funding shortages are major constraint on growth want bank loans, but difficult to get personal investment want to increase sales rather than cut costs look mostly at cash flow no projections or budgets

7.3, respectively. These tables aim to provide a summary account of the larger body of evidence in this thesis. They enable a clear set of prescriptions to be enunciated, which may be useful not only to practitioners, but also to academic analysts of small business strategy. This section now proceeds by taking each factor in turn from the tables, prescribing strategies and suggesting patterns of behaviour which should, when implemented, help the owner-manager of a new small firm to achieve growth and profitability.

### **7.5.1 Awareness**

- develop an awareness, not only of the industry in which you operate, but also of competitors
- appreciate that competitors are amongst your biggest threats
- keep a close eye on the activities of rivals, and seek information of them and their operations on a regular basis
- network as often as possible, building up contacts in the industry
- be willing to pay for specialist advice if it means the difference between success and failure
- be aware of your strengths and opportunities, and be ready to exploit them
- know your weaknesses and threats, and work hard to improve upon them
- be self-critical and carry out a regular appraisal of your strengths, weaknesses, opportunities and threats

### **7.5.2 Objectives**

- set clear long-term objectives
- set business, rather than personal, goals
- aim for long-term profit and a high rate of return
- target a specific niche and concentrate on developing your business within it
- cut costs where possible and/or try to develop a product that is differentiated from those of rivals

### **7.5.3 Targets**

- set long-term targets and work towards them
- have quantifiable financial goals
- compare forecast figures with actual, and work to improve on any shortfall
- analyse performance to discover where problems arise
- set targets for employees and evaluate their performance

### **7.5.4 Decision-Making**

- the owner-manager should have autonomy in strategic decision-making
- take into account employees' suggestions
- do not spend too much time discussing possible actions to the detriment of running the firm

### **7.5.5 Policies**

- learn from experience
- be willing to change if something is not working
- be adaptable, and listen to the dictates of the market-place

### **7.5.6 Commitment**

- commit to a plan of action and follow it through
- reinvest all profits
- maintain a daily involvement
- strive to achieve the goals you have set
- pay for help and advice if it will help the business in the long run

### **7.5.7 Motivation**

- offer employees financial bonuses
- involve staff in decision-making, taking into account their ideas to let them feel they have a say in their own future
- develop a team spirit



### **7.5.8 Quality**

- provide a high quality product or service to develop a long-term and loyal customer base
- monitor quality on a regular basis, either through your own system or one externally approved
- maintain a personal service
- be aware of new products and keep up-to-date with changes in the market
- assure customers with guarantees, where relevant

### **7.5.9 Communications**

- keep communications efficient, speedy and verbal
- have regular meetings with key personnel to raise any problems
- develop written procedure manuals for staff consultation, but do not become too bogged down with formalising processes and procedures

### **7.5.10 Information-Technology**

- implement and update technology, and learn how to use it correctly
- install PCs, mobile phones, faxes and electronic mail to improve information gathering, storage and retrieval, and to enhance communications
- use IT for networking, developing your awareness and building contacts
- learn how to deal with your own accounts, for example, using accounting software packages, in order to have up-to-date financial information at your fingertips

### **7.5.11 Finance**

- reinvest any profits to finance extra staff, and improve assets
- control costs wherever possible, and always seek the best deals
- deal with your own accounts [see above]
- prepare budgets and try to stick to them
- monitor cash flow on a daily basis

## 7.6 Theory Building and Future Research

What the prescriptive analysis developed above suggests is the possibility of building an overarching theory that provides a parsimonious and intuitively satisfying way of viewing diverse patterns of small firm behaviour. A core principle adopted in areas like Social Psychology, Sociology and Management and, in some measure, embraced by Industrial Organisation, is that conduct determines performance. This core principle can be used for theory building in the area of small business strategy.

The discussion that follows makes reference to Table 7.4, which presents a new theory for explaining firm performance by strategic behaviour. The basic equation,

$$\text{Performance} = F(\text{Conduct}) \quad (1)$$

provides a general point of departure. Performance is itself a qualitative attribute that experts can often evaluate with unerring accuracy and consistency without being entirely aware of the basis for so-doing. Here it is suggested that the principle features of performance are threefold: growth, productivity and profitability. This has the advantage of reducing a qualitative judgement to quantitative measures, but the disadvantage remains that it is multidimensional. Therefore a satisfactory way of aggregating these several measures into a one-dimensional index needs to be found and implemented. For example, in this work, cluster analysis was used to allocate firms to one of three performance ranks, using a combination of three performance measures, and thus providing an index against which conduct might be compared. Thus by a process of assigning proxies for

**THEORETICAL MODEL OF SMALL FIRM PERFORMANCE  
EXPLAINED BY STRATEGIC BEHAVIOUR**

**Table 7.4**

$$Performance = F(Conduct) \tag{1}$$

Where performance is proxied by a set of Performance Measures e.g. profitability

$$Index\ of\ Performance = f(Performance\ Measures) \tag{2}$$

Substituting (2) in (1) we get ∴

$$Index\ of\ Performance = f(Conduct) \tag{3}$$

Turning to RHS of (1):

$$Conduct = F(Goals, Techniques, Cognition) \tag{4}$$

So:

$$Index\ of\ Performance = F(Goals, Techniques, Cognition) \tag{5}$$

Proxies for measuring Goals, Techniques and Cognition are:

- |             |  |
|-------------|--|
| Goals:      | targets, objectives, policies                        |
| Techniques: | decision-making, quality, communication, IT, finance |
| Cognition:  | awareness, commitment, motivation                    |

performance and aggregation (e.g. using cluster analysis) one gets:

$$\text{Index of Performance} = f(\text{Performance Measures}) \quad (2)$$

and substituting (2) in (1) we get:

$$\therefore \text{Index of Performance} = f(\text{Conduct}) \quad (3)$$

Finally, conduct itself has an even higher dimensionality than performance. To use a metaphor, there may be a myriad of ways of creating a cake (*conduct*), but rather a few number of ways of evaluating it (*performance*) e.g. does it taste good, look good, smell good? The implementation of the theoretical framework above, for prescriptive purposes, suggested eleven measures of conduct (*viz.* ‘strategic characteristics’ in Section 7.5). For the purposes of parsimony in theory formulation, these eleven measures can be grouped under just three headings: Goals, Techniques and Cognition. Thus:

$$\text{Conduct} = F(\text{Goals, Techniques, Cognition}) \quad (4)$$

Under the heading of ‘Goals’ lie targets, objectives and policies. Under the heading of ‘Techniques’ lie decision-making, quality, communication, IT and finance. Finally, under the heading of ‘Cognition’ lie awareness, commitment and motivation. Expressed briefly, the theory built on, or grounded in, evidence to be presented here is that:

$$\text{Index of Performance} = F(\text{Goals, Techniques, Cognition}) \quad (5)$$

The implementation above of the prescriptive evidence shows that this theory provides a plausible separation of new business starts into groups of high, medium and low performance. The task remains of applying this theory of the connection between Goals, Techniques, Cognition and Performance to contexts hitherto unseen by the current investigator e.g. new, small firms in another country.

What this model allows is the quantifiable measurement of two often intangible factors, performance and conduct. The thesis has suggested a convenient new way of measuring firm performance, using 3 readily observed measures, which can be easily transferred and applied to other datasets. Conduct too can be proxied by 3 main factors, which can be further broken down into a total of 11 key measurable strategic characteristics. Defined as such, the model is readily transferable for application elsewhere, and therefore provides a useful method for analysing strategic behaviour and performance in the new small firm.

The evidence presented throughout this thesis flies in the face of writers who disagree that small firms can and do utilise strategic planning in the organisation of their businesses [*cf.* Storey (1994)]. This is not to say that some businesses are not run on a 'wing and a prayer'. Indeed, some firms appear to prefer the latter course of action. However, what this work has shown is that those small firms who use strategic planning in an effective manner will perform better, sometimes very much better, than those small firms who leave things to chance and deal with problems as they occur, on a reactive, rather than a proactive, basis.

The long-held belief of, for example, Mintzberg (1979) that the type of intuitive, visionary or reactive approach to running the firm, as expounded in his own writing, is the only and best way to go, is therefore repudiated. Instead, this work supports the theories of Porter (1980, 1985) that, to achieve and sustain competitive advantage, the firm should follow a number of formal measures which can be incorporated into its strategic planning processes. For example, it should take note of the Five Forces of Competition, and strive to beat these by means of cost-cutting, differentiation, or a combination of the two. If it can achieve this, then performance, as defined earlier in this work, should necessarily be enhanced.

Thus it has been shown that strategic planning, as defined in the literature and related primarily to large organisations, can be applied equally to the new micro firm. There is strong evidence to show that young firms plan ahead, on occasion up to 10 years; often longer than they have been in business themselves. It is those firms with longer planning horizons whose performance is shown to be superior [cf. Reid and Smith (1996)].

In addition, this work has addressed points where other literature has fallen short, as discussed in Chapter 2. The firms in this study have been very clearly grouped into measures of high, medium and low performance, using a combination of three very important factors, rather than just using vague measures [cf. Steene (1991); Variyam and Kraybill (1993)] or simple one-variable indicators such as profitability [cf. Baker *et al* (1993)]. Instead of looking at small firms by reference to their stage or phase of development [cf. Churchill and Lewis (1983); Peiser and Wooten (1983); Mount *et al* (1993)], which enables one merely to analyse firms by their organisational form, we are able to relate performance to strategies characteristic of varying levels of success.

Planning is clearly defined as being part of a strategic process [cf. David (1989)] and is related to empirical evidence [cf. Cooper (1993)], which facilitates comparisons between different levels of performance [cf. Aram and Cowen (1990)]. The fact that this study has evidence from more than one period, and therefore has some longitudinal aspect to it, allows the investigator to observe the effects of earlier strategic decisions [cf. Shuman and Seeger (1986)]. And finally, respondents' beliefs in the importance of various factors of their business are observed, related to performance, and observed again in the light of experience, to

test for self-awareness, adaptability and the capacity to learn from mistakes [*cf.* Bamberger (1989)].

Although the discussion of results has provided an extensive analysis of small firm strategies as they exist in the early years following business inception, there remain some questions still to be addressed by future research. In summary, these can be broken down under the following headings: investigation using additional available data; suggestions for further data gathering; and more sophisticated model building using available data. Each shall now be discussed in turn.

#### **7.6.1 Investigation using additional available data**

The scope of this thesis has covered the business strategy section of the administered questionnaire. However, the nature of the work means that additional data from Reid's Leverhulme Trust funded project are available for each of the firms under examination; on their markets, finance, costs, human capital, organisation and technical change. Further work can therefore make appeal to this additional body of evidence, linking strategies used within the firm to various other factors.

For example, Proposition 6 investigates the assumption that access to greater sources of funding will lead to enhanced performance. However, these results are relatively inconclusive. One reason for this is that the measure used for funding sources sums the results for several binary variables; either the firm does, or it does not, use a specific source. Instead, it is suggested that the level of funding attracted from each source may have more significance in predicting performance. The additional data available from the 'Finance' section of the administered questionnaire include evidence on, specifically, the level of grant support, bank

loans and outside equity which, with some manipulation, would enable the development of a better measure of outside funding and further testing of the model to be undertaken.

The larger study will eventually provide four years worth of data for all of the firms, rather than just the first two years used in this study. Thus the investigator will be able to compare the respondents' willingness to dilute equity in, for example, year one, with what actually happens over years one to four. This will facilitate a more in-depth examination of Storey's (1994) suggestion that a reluctance to share equity will restrict growth and high performance. By direct investigation of the gearing trajectories over time, it will be possible to compare respondents' willingness to dilute their equity holding with what actually happens, and to relate this to the firms' subsequent performance.

In Chapter 5 the suggestion is raised that the level of education of owner-managers might have a direct impact on their firm's performance. For example, if long-term strategic planning is thought to be important in enhancing performance (and it is shown in this work that it is), then it might be reasonably argued that those owner-managers with a higher level of education will also be those who are better able to devise strategic plans and forecasts. They might also therefore be those who are more capable of performing the types of variance analyses that this work suggests are useful. The larger study provides detailed knowledge of respondents' education and previous business experience, which should enable the testing of such a theory.

Finally, under this heading, in Chapter 6 it is suggested that the broad range of products offered by low performers in the belief that they are serving the customer through their adaptability, may not in fact be assisting their performance. Instead,



as suggested throughout this work, they may do better to follow Porter's (1980, 1985) suggestions and focus on a specific niche, narrowing their product range or numbers. Specific evidence is available on both the number of products and ranges offered by each firm, and it can be used to test the theory that firms with fewer, differentiated products, will perform better than those providing many varied goods or services.<sup>2</sup>

### **7.6.2 Suggestions for future data gathering**

Chapter 6 investigates budgeting within small firms, and the role of financial reports in decision-making. The findings suggest that, in general, high performers often have in-house accountants to perform forecasts and budgets, medium performers seek outside advice and concentrate on cash flow, but low performers prepare very few, or no, financial forecasts, only seeing an accountant for auditing, tax or wage bill purposes.

Thanks to the support of the *Chartered Institute of Management Accountants (CIMA)*, Professor Gavin Reid (CRIEFF, University of St Andrews) and Professor Falconer Mitchell (University of Edinburgh) will be able to investigate the accounting information systems (AIS) within small firms. The grant awarded by *CIMA* will enable further investigation of these small firms to be carried out, enhancing the data available, and allowing further evidence to be incorporated and interpreted along with the existing information. It will allow the team of researchers to examine the development, formality and structure of the AISs in young micro firms, and will enable this investigator in particular to test the theory

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<sup>2</sup> An alternative hypothesis that might be explored is that there is an optimum product range; above, or below it, performance deteriorates.

that higher performers have more sophisticated systems than both low and medium performers.

Given the importance played by respondents' belief in their firms' performance as compared to its actual performance, it might also be both useful and interesting to examine and compare the perceptions of a selection of the firms' customers. For example, if an owner-manager believed his firm were better than its rivals on customer service and product quality, is the perception of the customer similar, or does it differ? Such investigation would help to ascertain how accurate the owner-manager is in evaluating his own strengths and weaknesses.

### **7.6.3 Sophisticated model building**

Clearly, this work has thrown up some useful findings and hypotheses about the strategies deployed by new small firms. For example, the use of information technology is highly statistically significant, and there is evidence to suggest that a higher awareness and gathering of information on rivals can also lead to enhanced performance. Long-term planning, too, is shown to improve the firm's chances of growth and success, broadly defined.

However, what is also clear is that good performance does not depend on any one single factor, but on a combination of inputs, both tangible and intangible, which together provide the firm with a competitive advantage over rivals. Future work could attempt to explain performance by a combination of several criteria, using a multivariate model. One method of doing so, for example, might be factor analysis, which enables the user to identify relationships between sets of observed variables. Another possibility would be to use multiple linear regression analysis, which can also be used to study relations among variables. Whichever method is

used, the extent of such an undertaking is outwith the scope of this thesis, but the idea is there to be investigated at a later stage.

## **7.7 Conclusions**

Developed from findings throughout this work, the suggestions of Section 7.5 are prescriptive, and based on inductive evidence. However, they should, if implemented, help the small business owner-manager to focus his business towards achieving the goal of high performance. Of course, it does not account for those who have no particular desire for large expansion, but should assist them, nevertheless, in avoiding business failure. The prescribed strategies should be followed in conjunction with an adaptable and open-minded business policy. The owner-manager must always be ready and willing to change as the market dictates, and should maintain an awareness of trends and patterns in the industry. An ability to anticipate change should prove invaluable in achieving competitive advantage.

To some extent, success or failure depends upon the personality of the owner-manager concerned. Natural entrepreneurs will always find a way to succeed. However, for those who are less than 'naturals', bodies formed to assist small business development come into their own. Organisations such as the chambers of commerce or Enterprise Trusts should help small firms to develop the skills required to run and manage their business. To some extent, they do this already [*cf.* Reid & Jacobsen (1988, Chapter 5)], but evidence suggests that they could be more effective. Through training, they should impress upon prospective owner-managers the need for critical self-analysis and realistic appraisals of the strengths, weaknesses, opportunities and threats affecting their business. They need to stress also that competition is fierce and should not be ignored.

It would probably help those firms with cash flow difficulties to be offered free and readily available professional advice, for example, on marketing, and for it to be made known that this advice was available [*cf.* Curran and Downing (1993)]. Small firms might prove willing to forgo the Enterprise Allowance in favour of such initiatives. New owner-managers should be encouraged to network, and regular meetings at Enterprise Trust premises could provide a forum for such activities. This should be on-going, rather than only during the first year or two following inception. Simply getting together to discuss problems and make contacts can be a useful process for the small business owner-manager. It might also be worth considering providing small firms with open access to computer networking facilities and internet pages, perhaps charging a small fee for such a service.

The fledgling entrepreneur would probably benefit from being shown some case studies of firms that have failed due to their ignorance of competition. An injection of stark reality at the formation of their new business might encourage them to be always alert, although advisors should be careful not to kill off any early enthusiasm, so complementary case studies on successful small firms should also be included in training courses.

The owner-manager must decide why he is running the business. If it is purely for personal goals, or just to make a living, then he will probably be naturally more cautious, and less willing to take risks. However, if he decides that he wants success, he must commit himself totally to long-term strategic objectives. He should be encouraged to target a specific niche market, and to control costs as much as possible. Advisors should also encourage owner-managers to try and

bargain with suppliers on costs, and might provide courses to train the amateur businessman in assertiveness and bargaining techniques.

Business advisors ought to be skilled in methods of setting financial and personal targets, and should help and encourage small firms to do the same. Specific goals should be set, and performance compared with forecasts. Again, advisors should help entrepreneurs learn to analyse their performance and uncover problems. Not hitting targets need not necessarily be an indicator of failure, but the owner-manager should be encouraged to seek out the reasons for falling short of the targets set.

The acquisition and implementation of information technology is found to be an extremely important factor in new, small firm success. Perhaps some owner-managers are frightened to use new technology because of a relative ignorance of what is available, and of the advantages it offers. Business advisors can help by placing a heavy emphasis on IT training. New owner-managers should be shown the possibilities on offer, and made aware of the benefits that may be conferred by effective use of IT. In particular, they should be taught the value of networking, which will heighten their awareness of the business environment. And they should learn how to deal with their own financial accounts, which will provide immediate and accurate information, enabling speedy decisions to be made.

The major strategic problems amongst small firms concern their lack of self-awareness, a naïveté about the strength of competition, and a failure to implement information technology in an effective manner. Enterprise agencies can help in all regards, by forcing owner-managers to carry out a critical analysis of strengths, weaknesses, opportunities and threats, by specifically stating that competition will

be a major threat, and by allowing access to training courses and practice in the use of information technology.

This thesis was developed to address several objectives, each of which has now been covered in some detail. It began with a critical analysis of the relevant literature, which raised a number of issues worth pursuing further. It discussed the development of two new instruments for use in fieldwork data-gathering. In-depth analysis of the data thus collected showed that small firms are able to, and do, make strategic decisions, and that those who do this most effectively will benefit from enhanced performance. Finally, the thesis prescribes methods of strategic behaviour which should assist the small business owner-manager in the running of his firm.

For new entrepreneurs seeking high performance, it is hoped that this work has provided some fresh ideas. By presenting recent evidence on the actual strategies followed by small firms, and by breaking these into groups of high, medium and low performers, it has been possible to prescribe actions to follow or adopt, while flagging those to be avoided. Those small business owner-managers who seek merely to earn a living would also do well to follow the suggestions of section 7.5, if they are to defend themselves against competitors, and thus avoid business failure. However, for those with greater ambition, the prescriptions outlined above, together with an open-mind, a flexible attitude and a willingness to work hard, should aid them in their search for high performance and long-term success.

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